

Meeting: IPSASB Consultative Advisory Group
Meeting Location: New York, USA
Meeting Date: June 20, 2022

Agenda Item 4

For:
 Approval
 Discussion
 Information

MEASUREMENT (ED 77) – CURRENT OPERATIONAL VALUE (COV)

Project summary	The project objective is to revise IPSAS requirements for measurement, provide guidance on measurement and address the treatment of transaction costs and borrowing costs.	
Meeting objectives	Topic	Agenda Item
Discussion Items	Measuring Assets in the Public Sector	4.1
Other supporting items	Appendix A: IPSASB Due Process Checklist	4.2

Measuring Assets in the Public Sector

Background

1. In April 2019, the IPSASB completed the first phase of its measurement project and issued its Consultation Paper (CP). This CP proposed the most used measurement bases in IPSAS be defined and practice guidance be developed to support consistent application in practice. The CP also proposed adding Fair Value, aligned with Fair Value as defined and applied in IFRS 13, *Fair Value Measurement*. The CP included an illustrative Exposure Draft (ED) to show respondents the CP's proposals.
2. Respondents to the April 2019 Measurement CP strongly supported the IPSASB's preliminary view that Fair Value is relevant and applicable in measuring some assets and liabilities in the public sector. Constituents' concerns with Fair Value related to the fact that when an item is held for its operational capacity, as is often the case in the public sector, Fair Value is difficult and inappropriate to apply because the following concepts embedded in Fair Value as defined by IFRS generally are not applicable:
 - (a) Highest and best use¹; and
 - (b) Maximizing the use of market participant data.
3. While respondents agreed the Fair Value definition proposed is applicable in some circumstances (where assets are held to generate income either through use or sale), they also noted the definition is unlikely to be appropriate as a current value measurement basis in most public sector cases (where assets are held to deliver a service). Respondents expressed the view that a public-sector-specific current measurement basis is required.
4. When assets are held for their operational capacity in the public sector, they are held to achieve a service delivery objective. Holding an asset to meet a service delivery objective often results in an asset being held in a capacity other than that of one that satisfies its highest and best financial use (as required by a Fair Value measurement). For example, an entity may have a service delivery objective to provide medical services in a city center, when the highest and best use of the building use of the building or site might be commercial or residential development.
5. In response to constituents' concerns raised in the CP, the IPSASB developed a current value measurement basis unique to the public sector – Current Operational Value (COV). Given Fair Value is applied to items held for their financial capacity, COV was developed specifically for assets held for their operational capacity (for example, property, plant, and equipment).
6. The objective of a COV measurement is to estimate the value of a non-financial asset in achieving the entity's service delivery objectives at the measurement date. COV provides measurement information in the context of the current value of the asset in its current use. This provides users with:
 - (a) In the statement of financial position, the amount an entity would incur at the measurement date to replace the service potential to achieve its present service delivery objective.

¹ Highest and best use considers a market participant's ability to generate economic benefits by using the asset in its *highest and best use* or by selling it to another market participant that would use the asset in its highest and best use.

- (b) In the statement of financial performance, the consumption of the asset, through depreciation, which reflects the amount the entity would incur to acquire the service potential needed to provide the service at the prevailing prices at the point in time when an asset is measured. This differs from Historical Cost, which reflects the consumption of the asset in terms of the prices that prevailed when the asset was acquired.
7. In December 2021, the IPSASB reviewed a summary analysis of responses to ED 77, *Measurement*. The ED was generally well-received. Respondents commended the IPSASB for taking on this complex project and developing guidance to address these issues in the public sector.
8. As part of a summary analysis provided to the IPSASB at the March meeting, staff indicated that the responses to COV, namely SMCs 5 and 6, were split between:
- (a) Supporting the principles proposed;
 - (b) Building on the principles proposed; and
 - (c) Departing from the principles proposed.

The split was fairly even with approximately a third of respondents in each category.

9. Approximately two-thirds of respondents supported the direction and objective of the COV basis. However, in addition to the comments set out in table 2 below, many of these respondents requested further clarity on how to apply COV and to simplify the principles for understandability. For example, one respondent noted the definition of Fair Value clearly indicates how the asset should be measured. This does not hold true for COV, which has a conceptual definition requiring an in-depth review of the COV appendix in *[draft] IPSAS [X], Measurement* to understand the concepts. This clarification should be enhanced throughout the COV guidance.
10. Outside of the support for moving ahead with the COV principles, the following key themes were prevalent across SMCs 5 and 6 in Table 1:

Table 1: Overarching themes in SMCs 5 and 6

Overarching Themes	Summary Comments from Respondents and CAG Members ²
Definition	<p>Many respondents argued that the terms used were vague and could thus be interpreted differently by various stakeholders. Respondents thus encouraged the IPSASB to enhance the clarity of the terms used in the definition, and the associated guidance provided in the Appendix.</p> <p>CAG comments: Some CAG Members encouraged further analysis of the definition and COV principles to ensure they can be effectively implemented.</p>
Valuation Practice	<p>Some respondents noted that the use of the income approach to estimate an asset's current operational value is inconsistent with the intention for the current operational value to be an entry value.</p>

² Comments made by the IPSASB Consultative Advisory Group (CAG) meeting held on December 6, 2021.

	<p>Some respondents noted that the detailed calculation of a Current Operational Value may be complex in practice, depending on the availability and comparability of observable inputs.</p>
<p>Non-Applicability of Current Operational Value</p>	<p>Some respondents are of the view that providing public-sector-specific practical guidance and illustrative examples to help public sector entities apply the principles in IFRS 13, represents a better option than the proposed guidance.</p> <p>CAG comment: Several CAG Members acknowledged there is a need to develop a basis that is different from Fair Value but advised against shaping Fair Value for public sector purposes as it would create confusion and would not represent the difference between operational and financial capacity. Confusion may arise because Fair Value is already difficult to apply, the difference between COV and replacement cost is not clear, and the definition may not be fully operational.</p>
	<p>Many respondents are of the view that the IPSASB has not clearly articulated why COV would be a more appropriate basis to measure the current value of operational capacity assets instead of the IFRS 13 Fair Value measurement basis.</p> <p>CAG comment: Several CAG members commented that a key fair value concept, namely, “highest and best use” does not work in the public sector, and it is therefore important to develop public sector-specific measurement principles.</p>

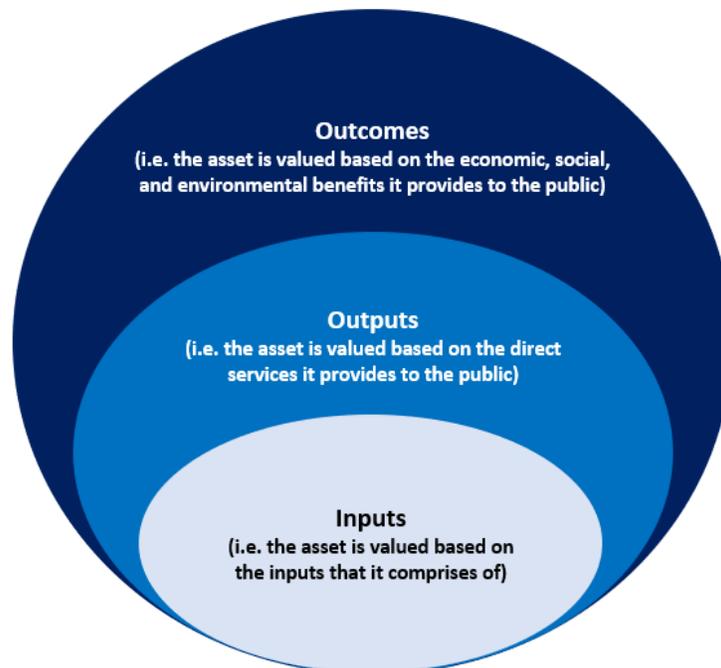
11. In addition to the comments set out in Table 1 above, some respondents to ED 77 noted that the proposed COV basis does not adequately capture the public sector value the asset provides. As part of the development of COV, the IPSASB agreed that, when an asset is held for its operational capacity, the most relevant information to the users of financial information is the current value of the asset in its current use, as this provides users with useful information about the public sector. The IPSASB, elected to value the asset based on the inputs that comprise the asset, as opposed to the outputs provided by the asset, as this valuation would reflect the amount an entity would incur at the measurement date to replace the capacity to achieve its present service delivery objective using its existing assets.
12. Based on responses, staff identified two key issues for CAG members’ consideration and discussion as they relate to COV. CAG Member advice will assist the IPSASB in determining approaches to consider the following issues:
 - (a) **Issue 1:** Capturing the public sector value of the asset; and
 - (b) **Issue 2:** Core principles of a public sector measurement basis.

Issue 1

13. Some respondents indicated COV, as a public sector measurement basis, does not reflect the value of the assets in the way the public sector uses them – i.e., to deliver direct services to the public, and/or to provide a wider community benefit. The community benefits may range across an economic, social, and environmental spectrum, and the quantum of benefits will often depend on the stakeholder being considered.
14. During the development of ED 77, the IPSASB spent considerable time discussing alternatives to capture the value of public sector assets. These discussions focused on whether to measure the

service or measure the physical asset. With additional perspectives from respondents, staff considered it prudent to revisit the IPSASB decision, taking into account additional views and information provided as part of stakeholder responses. In assessing respondents' comments, staff identified three lenses through which the measurement of public sector assets could be viewed:

- (a) **Outcomes:** This lens values the asset based on the broader economic, social, and environmental benefits the item provides.
 - (b) **Outputs:** This lens values the asset based on the outputs the item is held to provide.
 - (c) **Inputs:** This lens values the asset based on the underlying physical item.
15. The 'outcomes' and 'outputs' lenses are particularly relevant in the public sector where entities generally hold assets to deliver a service or provide a wider benefit.



Outcomes

16. An outcomes-based approach is the broadest measurement approach available. It places the emphasis of the valuation on the management of the asset to achieve the desired economic, social, and environmental benefits for a broader group of users than merely the direct users of the services.
17. For example, a school has numerous economic and social benefits that are not captured under the existing measurement bases. The "outcomes" approach considers benefits such as:
- (a) Reduction of poverty, crime, gender-based violence, and homelessness as a result of an educated society;
 - (a) Increased economic growth as a result of higher salary earners;
 - (b) An equal and empowered society;

- (c) Good citizenship and civic involvement;
 - (d) Healthier lifestyles;
 - (e) Better career prospects; and/or
 - (f) Attracting homebuyers and increasing property values around the school.
18. Staff have noted that an outcomes-based approach to valuation ties in with the issues being considered by the International Valuation Standards Council (IVSC), with respect to defining and estimating 'social value'. The concept of 'social value' is an area of growing government, public and commercial interest. The IVSC have noted that social value can be confusing for a valuer because the traditional theories of value are being challenged. This requires the valuer to think deeply about the concept of social value, and importantly what the value of these assets and benefits are to both the owners and wider stakeholder groups (i.e., the public). However, valuers and accountants are not able to define and reliably estimate social value with the degree of certainty required for financial reporting. Pursuing valuations using this lens would result in asset recognition criteria not being satisfied because an 'outcomes' lens would result in too much uncertainty.
19. The concept of economic, social, and environmental value is in its infancy in many jurisdictions, and as such is prone to challenges as the practice develops. In assessing the feasibility of the development of an appropriate public sector measurement basis that takes a holistic approach to value a public sector asset by measuring its economic, social, and environmental benefits to the wider community, staff is of the view, that this 'lens' is beyond the scope of the project.

Outputs

20. Since it is not feasible to develop a measurement basis to value assets using an outcomes-based approach, then the next question is whether it is appropriate to measure a public sector asset by considering the outputs associated with the service delivery objectives for which the asset is held. Valuing the outputs, i.e., the services the asset delivers to the public, focuses measurement on why public sector assets are held, to deliver services, which is the fundamental difference between the public and private sector assets. Respondents to the CP, and SMCs 5 and 6, noted that a public sector measurement basis should take into consideration the differences between the public and private sectors.
21. An example of measurement focusing on the asset 'outputs' is to focus on the service associated with the service delivery objective associated with the asset. Using a school as an example, the school could be measured based on the value of the education delivered to the public. This could be determined based on:
- (a) The amount required to deliver the education; or
 - (b) The amount individuals pay or would pay, to receive the education.
22. However, an outputs-based measurement is inconsistent with how all other non-financial assets are measured in IPSAS financial statements. Financial statement measurement currently focuses on the physical value of the asset, i.e., the inputs, rather than the value of the services they deliver. Valuing the asset based on the services provided is not well-established and similar to an 'outcomes'-based approach, an 'outputs'-based approach would result in asset recognition criteria not being satisfied because there is not a well-established method to value the service provided by an asset.

23. The IPSASB previously rejected the idea of measuring public sector assets based on the value of services they provide during the development of the COV concept in the ED because recognizing the value of the service the asset provides is inconsistent with how all other assets are measured on the balance sheet.

Inputs

24. Where the outputs and outcomes-based approaches present challenges, the inputs-based approach presents solutions:
- (a) **Consistent with IPSAS principles.** Throughout IPSAS the measurement of non-financial assets is based on the value of the underlying item (inputs), not the service or goods it delivers (outputs). For example, a hospital is measured based on the value of the building, not the medical services it provides. This is because the value of the non-financial asset presented in the financial statements must fairly reflect the cost of service, operational capacity, and the financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes (Chapter 7.2 of IPSASB Conceptual Framework). Measurement focusing on the physical item, while held for service delivery, offers a reliable and consistent measurement that is useful to financial statement users. Outputs and outcomes-based approaches are forward-looking, lending themselves to extreme measurement uncertainty as they value an asset based on the value of the future services it could deliver. This is inconsistent with the purpose of financial statements which offer a financial snapshot of an entity at a point in time. This information is historical in nature.
 - (b) **Well-established.** Given that inputs-based measurements are applied throughout IPSAS, measurement bases from which core principles can be used to develop a public sector measurement basis and measurement techniques that can be used to estimate a public sector measurement basis are well established. The familiarity IPSAS users have with an inputs-based measurement ideology will enhance the consistency and reliability of measurement.
 - (c) **Consistent with ED 77 principles.** An inputs-based measurement was proposed in ED 77. While some respondents encouraged the IPSASB to focus the public sector measurement basis on the public / private sector difference, the majority, approximately two-thirds, of respondents supported the principles proposed.
25. While some respondents encouraged the IPSASB to focus the public sector measurement basis on the public / private sector difference, as noted above, they did support the principles proposed. The additional views provided by respondents allowed the IPSASB to evaluate the measurement lens from a different perspective than when the principles in the ED were established (development of the ED focused on whether measurement should focus on the physical asset or the service provided).
26. Furthermore, while the IPSASB agreed that the difference between the reason the private and public sectors results in the need for a public sector measurement basis, the public sector difference does not warrant a move away from the inputs-based lens which is applied throughout IFRS and IPSAS.

Questions for CAG Members:

Do the CAG Members agree that the IPSASB should continue developing Current Operational Value as a measurement basis that focuses on the valuation of an asset based on its inputs?

Issue 2:

27. Respondents to the CP identified a key difference between public sector and private sector assets. When developing ED 77, the IPSASB developed COV to address this key difference between the public and private sectors:

Assets in the public sector are generally held to deliver services (operational capacity), while assets in the private sector are generally held for their ability to generate profits (financial capacity).
28. The IPSASB agreed that a measurement basis unique to the public sector was required because using existing measurement bases developed for the private sector, specifically Fair Value (FV), did not address this public /private sector difference and provided users of public sector financial information with an asset value that was relevant for decision making purpose when the asset was held for its operational capacity³.
29. Respondents, to both the CP and the ED, strongly supported including FV, aligned with IFRS 13, in the *[draft] IPSAS [X], Measurement*. These respondents agreed with the IPSASB that when items are held for their financial capacity, FV provided relevant information for users to make decisions. However, these respondents also indicated that FV was not appropriate in most public sector circumstances because FV requires an asset to be measured at its highest and best use. Since holding assets for their highest and best use is often not the case when assets are held for the delivery of services in the public sector (e.g., a hospital held to deliver medical services), respondents indicated that a FV measure did not reflect the value of the asset to the public sector entity, and therefore did not provide a financial statement user with relevant information.
30. The IPSASB developed the principles of COV to address this key concern identified by respondents to the Measurement CP. The context in which the principles are set is that of a current value measurement basis which provides monetary information about assets, and related revenues and expenses, using information updated to reflect conditions at the measurement date. Respondents noted a current value measure was necessary for the public sector to balance the financial-capacity-focused FV measurement.
31. To address the issue of 'highest and best use' in the public sector, ED 77 proposed that a public sector measurement basis measure assets in their existing use.

³ The IPSASB did not decide that FV could not be applied in all circumstances, only that it did not provide the most relevant information when applied to assets held for their operational capacity. Respondents agreed with this and also strongly supported the applicability of FV in the public sector when circumstances are appropriate (i.e., items are held for their financial capacity).

Existing use: measuring the existing use of an asset disregards potential alternative uses and any other characteristics of the asset that could maximize its market value, as existing use generally reflects the policy objectives of the entity operating the asset.

For example, a building that is currently being used as a hospital is fulfilling its social policy objective to deliver medical services to a community. An example of a higher financial use of the building may be commercial or residential development. Requiring the asset to be valued in its existing use means the entity values the building as a hospital, not at another use that would yield a higher economic return.

32. Existing use valuation is critical in the public sector because it measures the value of the asset to the public sector entity, and ultimately citizens of the jurisdiction as the asset is being used to serve their needs.
33. Clarifying that valuing an asset based on how it is currently being used is a core principle in COV, identifies a key difference between Fair Value and Current Operational Value, addresses the public sector difference identified by respondents, and maintains consistency with the principles proposed and supported.

Question for CAG Members:

Do the CAG Members agree that valuing an asset based on how it is currently being used is a core principle in COV, and should be clarified in IPSAS Measurement?

Appendix A: IPSASB Due Process Checklist (condensed to include portions relevant to the CAG)

Project: Measurement

#	Due Process Requirement	Yes/No	Comments
A. Project Brief			
A1.	A proposal for the project (project brief) has been prepared, that highlights key issues the project seeks to address.	Yes	The IPSASB considered the project brief at its March and June 2015 meetings as part of its Work Plan discussions. The project brief was approved in June 2015 (see the June 2015 minutes).
A2.	The IPSASB has approved the project in a public meeting.	Yes	When the project went live in March 2017 the IPSASB made minor amendments to the project brief and re-approved it. See the approved project brief and the March 2017 minutes .
A3.	The IPSASB CAG has been consulted on the project brief.	N/A	This step was not in effect for this project at this point in time.
B. Development of Proposed International Standard			
B1.	The IPSASB has considered whether to issue a consultation paper or undertake other outreach activities to solicit views on matters under consideration from constituents.	Yes	The IPSASB issued a Consultation Paper on April 30, 2019.
B2.	If comments have been received through a consultation paper or other public forum, they have been considered in the same manner as comments received on an exposure draft.	Yes	All comments received have been publicly posted on the website. The IPSASB has deliberated the feedback received at public IPSASB meetings in forming its views on how to develop the measurement suite of exposure drafts.
B3.	The IPSASB CAG has been consulted on significant issues during the development of the exposure draft.	Yes	Agenda Item 8 from December 2019 meeting sought the CAG's views on the significant issues to be addressed in the development of the exposure drafts.

#	Due Process Requirement	Yes/No	Comments
C. Public Exposure			
C1.	The approved exposure draft has been posted to the IPSASB website for public comment for an appropriate period.		ED 77 was published in April 2021. Comments were requested by October 25, 2021.
C2.	Comments on the exposure draft have been posted to the IPSASB website after the end of the exposure period.		45 comment letters to ED 64 were received. All responses were made available publicly on the IPSASB website.
D. Consideration of Respondents' Comments on an Exposure Draft			
D4.	The IPSASB CAG has been consulted on significant issues raised by respondents to the exposure draft and the IPSASB's related responses.	Yes	This Agenda Item seeks the CAG's views on significant issues raised in the comment letters received.
D5.	Significant comments received through consultation with the IPSASB CAG are brought to the IPSASB's attention. Staff have reported back to the IPSASB CAG the results of the IPSASB's deliberations on those comments received from the CAG.	N/A	The comprehensive review of responses will be presented to the IPSASB for detailed consideration in 2022.