

April 8, 2013

Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street, 8th Floor
Toronto, Ontario M5V 3H2 CANADA

**Re: PSAB Staff Comments on Exposure Draft
“Conceptual Framework for General Purpose Financial Reporting by Public
Sector Entities: Measurement of Assets and Liabilities in Financial
Statements”**

Thank you for the opportunity to provide our perspectives on the proposals in this Exposure Draft (ED). We would like to express our support for this important effort and we hope our comments will contribute to its successful advance.

Significant progress has been made by the Board and its staff towards the inclusion of a useful guidance on the topic of measurement in the proposed conceptual framework. This accomplishment is noteworthy as measurement has been cited as the most under-developed area of current conceptual frameworks, including our own.

A member advanced an alternative view premised on the need to include a measurement objective in the conceptual framework. Aspects of Mr. Warren’s approach and its application resonated with us. While we do not support all of Mr. Warren’s positions, there is merit in assessing whether a measurement objective can be identified.

Given the scope of the broader undertaking to develop a new conceptual framework, IPSASB has understandably divided the task into components. Once each component has been exposed, we encourage IPSASB to give pause and to challenge whether the components integrate effectively. Thru such a process it may be possible to clearly focus on a measurement objective.

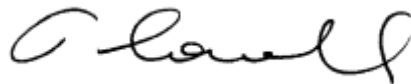
We strongly support the need to distinguish between financial and non-financial assets in public sector financial reports. Doing this enhances the usefulness of the financial information by reporting financial capacity separate and apart from operating capacity. PSAB has long held this to be a key distinguishing characteristic of public sector financial reporting.

We appreciate the opportunity to comment on this ED. We are very supportive of IPSASB's conceptual framework initiative and wish IPSASB success in integrating these proposals with other phases of the framework and the key characteristics document.

Responses to the Specific Matters for Comment in the ED are set out in Appendix A to this letter. Additional comments about the ED by paragraph are provided in Appendix B.

Please note that these comments are the views of PSAB staff and not those of the Public Sector Accounting Board (PSAB).

Sincerely,



Robert Correll CPA, CA
Consultant
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Specific Matter for Comment 1:

Do you agree that the selection of a measurement basis should be based on the extent to which a particular measurement basis meets the objectives of financial reporting? If you think that there should be a measurement objective please indicate what this measurement objective should be and give your reasons.

A: Discussing and settling on a measurement objective may help to integrate the components of the project. The measurement objective set out in the alternative view of Mr. Ken Warren strikes us as being consistent with aims set out in the ED and is a good starting point. Our views on the application of this measurement objective are provided in our response to matter 3.

Specific Matter for Comment 2:

Do you agree with the current value measurement bases for assets that have been identified in Section 3? If not, please indicate which additional measurement bases should be included or which measurement bases should not be included in the Framework?

A: The list of current value measurement bases is useful and complete.

However, in our view the statement in paragraph 3.4 is too limiting. Paragraph 3.4 states “market value is particularly appropriate where the asset is being held for sale...”. Without further explanation, some may interpret the words *held for sale* narrowly, avoiding the use of market value although a price obtained in an open, active and orderly market can be readily obtained. A specific suggestion to address this matter is given in Appendix B.

We agree with the statements in paragraphs 3.7 and 3.8 about the suitability of market value and the limitations in its usefulness, including the statement that “exit-based market values... are unlikely to be useful for many operational assets.”

Paragraphs 3.24 and 3.25 discuss the application of replacement cost when measuring the cost of services. The assertion is made that “replacement cost provides a relevant measure of the cost of the provision of services.” In our view, the supporting discussion is not sufficiently balanced, as it reflects the presumption that cost of service should incorporate the cost of asset replacement. In our view, the relevance of this measure is rebuttable, as many users seek accountability in relation to past decisions.

A measure of the cost of service based on replacement cost is of value in setting future rates. Setting future rates is a management exercise, whereas a principal aim of financial reporting is demonstrate management’s accountability. In many jurisdictions, this accountability is reported in relation to the plan or budget adopted by the oversight body. To ensure considerations associated with sustainability are not overlooked, supplementary information reported on in relation to specific key services could be reported.

Specific Matter for Comment 3:

Do you agree with the approaches proposed in Section 4 for application of:

- (a) *The fair value measurement model to estimate the price at which a transaction to sell an asset would take place in an active, open and*

orderly market at the measurement date under current market conditions. If not, please give your reasons; and

- (b) *The deprival value model to select or confirm the use of a current measurement basis for operational assets. If not please give your reasons.*

A: Public sector financial statements should distinguish a public sector entity's financial capacity from its operating capacity. This enhances the information available to users who wish to assess the extent of the resources available to meet financial claims or which can be transformed into operating capacity. We agree with Mr. Ken Warren's assessment that current prices and exit based prices provide the most useful information about financial capacity. The most relevant substitute measure applies when application of for current prices and exit based prices are not practical of faithful representation. The judgment as to practicability of faithful representation can be made at a standards level.

In the case of financial instruments, the PSA Handbook requires derivatives and equity instruments quoted in an active market to be measured at fair value. Public sector entities the option of extending fair value measurement to other financial instruments when it is consistent with a risk management or investment strategy has been defined and implemented at the reporting entity level.

We support the assertion that the bases of measurement used when reporting on operating capacity and the cost of services need to be useful, both in holding the entity to account and for decision making purposes. As determining the most faithful representation of operating capacity is more problematic, it may be that this judgment is best applied at the standards level.

We are not convinced that current entry prices provide the most faithful representation of operating capacity and the cost of services. In these areas, our users expect public sector entities to be accountable in relation to decisions associated with the allocation of resources raised in the current and preceding periods. A budget-to-actual comparison is an integral aspect in supporting this accountability. Current entry level prices are useful. However, the information provided is relevant to setting of rates that will apply to future periods and decisions associated with raising revenues for future periods.

Application of deprival value model as envisioned in the ED always results in the use of a basis of measurement grounded on current prices. Deprival value may indicate *replacement cost* should apply. As it is common practice to allow for future needs when constructing new infrastructure projects, the accounting for excess capacity will require evaluation. As well, reporting a cost of service based on an economic measure of replacement cost may not faithfully represent decisions associated with infrastructure design that may not directly contribute to cash flows or service potential. These considerations can include decisions about location, environmental and aesthetic aspects. A significant degree of subjectivity will be associated with any application of a measure based on replacement cost.

Alternatively, if the deprival model indicates a recoverable amount should apply, this will be either *value in use* or *net selling price*. Of these two, net selling price is likely to involve the least subjectivity. On the other hand, if the deprival value model is mandated, many public sector entities will need to assess the current reproduction cost of assets as this information is essential to the measure of value in use.

Our concern with value in use is that it is not a faithful representation for accountability purposes. Estimating the cost to replace the operating capacity of existing infrastructure with a new asset is a subject associated with a future

decision and does not lead to a relevant assessment of accountability for the current reporting period.

Specific Matter for Comment 4:

Do you agree with the proposed measurement bases for liabilities in Section 5? If not, please indicate which additional measurement bases should be included or which measurement bases should not be included in the Framework?

A: Yes.

However, in our view the statement in paragraph 5.6 is too limiting. Paragraph 5.6 states "...for example, for liabilities under derivative financial contracts that are traded on organized exchanges." It is our concern that if unchanged, this illustration may be used as an excuse for not applying market value when it is valid to do so.

The supporting text needs to clarify circumstances when a reliable measure can result from market values obtained from open, active and orderly markets to measure items that may not themselves be traded. Many derivatives are not themselves exchange-traded as they are contracts entered into outside of a financial market. A derivative is simply an agreement between two or more parties that will result in one or more settlements in future periods based upon the changes in a specified price, rate, index or other variable. As long as the variable is quoted in an open, active and orderly market, the obligation (or benefit) associated with the derivative can be reliably measured. A specific suggestion to address this matter is given in Appendix B.

Appendix B
Editorial Comments

The following changes to paragraph 3.4 are suggested:

...Market value is particularly appropriate when information is available from an open, active and orderly market, or where the asset is being held for sale and where it is judged that the difference between entry and exit values is unlikely to be significant.

The following changes to paragraph 5.6 are suggested:

...Such a measurement basis may be appropriate, for example, for liabilities under derivative financial contracts when their value changes in response to the change in a specified rate, index, rating or other variable based on transactions in an open, active and orderly market. ~~traded on organized exchanges.~~