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June 10, 2011

Ms. Stephenie Fox
Technical Director
International Public Sector Accounting
Standards Board
International Federation of Accountants
277 Wellington Street West, 6th Floor
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Ontario M5V 3H2
CANADA

Dear Ms Fox

Phase III of the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements

As stated in our letter dated June 10, 2011 on the Exposure Draft of phase I of the IPSASB's Conceptual Framework project, the IDW recognizes that there is a distinct need for a conceptual framework for general purpose financial reporting by the public sector. We continue to believe that, as stated in our letter to you dated 31 March 2009, the discussion is of fundamental importance for the future development of International Public Sector Accounting Standards.

In the aforementioned letter, to which we refer, we also stated our support for the IPSASB in now concentrating significant resources on bringing this important project forward, but expressed our concern as to whether the IPSASB's timetable may be overly optimistic, as it would essentially mean that the IPSASB would complete the project independently – and thus likely ahead – of the IASB's Conceptual Framework Project.

Indeed, in respect of this phase of the project we also accept that differences between the public and private sector will need to be addressed, but nevertheless believe that at a conceptual level there are likely to be significant areas of common ground between the two sectors, and therefore also urge the Board to confer with the IASB on the issues dealt with in this phase of the project prior to finalizing the project as a whole.

For example, whilst there may be public sector specifics that mean the selection of different measurement bases for a particular element would be different from the private sector, the bases that are hitherto available are unlikely to differ. It remains to be seen whether in the future further possibilities will evolve for measurement within either sector compared to the other.

Having said this, we believe the IPSASB has posed the right questions to gain insight in to the views of its constituents. We include our responses to the Specific Matters for Comment in an appendix to this letter.

However, we would also like to question why fair value has not been given more attention as a measurement basis in the discussion in this phase of the project, particularly as the IPSAS dealing with financial instruments require fair value to be used, and we suspect that when such instruments are held for trading there is no real difference whether the entity holding the asset is within the private or the public sector. A discussion of the merits and disadvantages of fair value would seem to be appropriate in this phase of the Framework.

We hope our comments in the Appendix will be useful to the IPSASB in drafting this phase of the Framework. We would be pleased to answer any questions that you may have or discuss any aspect of this letter.

Yours sincerely

Klaus-Peter Naumann
Chief Executive Officer

Gillian Waldbauer
Technical Manager International Affairs

Appendix

Specific Matter for Comment 1

Should the role of the Framework be to identify factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances, rather than specify a single measurement basis or combination of bases?

Yes, the Framework should provide a sound basis to guide standard setters – and in the absence of a standard on a particular issue preparers – in identifying factors that are relevant in selecting a measurement basis for particular assets and liabilities, and also items of income and expenditure, in specific circumstances that can provide the most useful information for decision makers.

Standard setters should thus refer to the Framework when specifying a single measurement basis or combination of bases for particular items in specific circumstances. Similarly, the Framework should also provide a point of reference for preparers faced with circumstances not previously dealt with in financial reporting standards.

Specific Matter for Comment 2

If, in your view the Framework should specify a measurement basis or combination of bases (or approach in the case of deprival value), which should that be?

Single Measurement Bases

a) *Historical cost.*

b) *Market value.*

c) *Replacement cost.*

Combinations of Bases/Approach

d) *Deprival value.*

e) *Historical cost and market value.*

f) *Replacement cost and market value.*

g) *Historical cost, replacement cost, and market value.*

Others

h) *Another measurement basis or combination of bases/approach.*

Please explain why you support a particular measurement basis or combination of measurement bases/approach and your reasons for rejecting alternatives.

The Framework should specify each of the various measurement bases that could be relevant in particular contexts, to enable standard setters to make informed decisions when determining whether a particular basis or a combination of bases should be applied to an individual item. The Framework should therefore identify, define and describe each measurement basis, and discuss the extent to which each satisfies the qualitative criteria identified in Phase 1 of the IPSASB's Conceptual Framework Project.

In addition to the bases listed above, value in use and net selling price should also be discussed in their own merit as opposed to within the deprival value concept.

Specific Matter for Comment 3

The Consultation Paper discusses the following measurement bases: historical cost, market value, and replacement cost. It also discusses the deprival value concept which does not describe a single measurement basis, but rather a means by which a basis may be selected that is relevant to the circumstances. Value in use and net selling price are discussed in the context of the deprival value model.

In your view, is this discussion complete, balanced and fair? If not, please indicate what in your view is missing or in what respects you consider the discussion does not draw out the strengths and weaknesses of the various bases (or approach in the case of deprival value).

We are concerned that the deprival value concept is not well known, and is not a measurement basis in its own right; rather it assists in determination of the most appropriate measurement basis in a particular set of circumstances (decision tool).

In addition, whilst we recognize that paragraph 1.14 of the consultation paper explains why fair value is not included, given its prominence in the discussions surrounding financial reporting by the private sector – in particular for financial instruments, which are also prevalent in the public sector – we do not share the view that no discussion of fair value should be included.

As explained in paragraph 4.10, replacement cost provides input for future decision making, it would be helpful for paragraph 4.8 to also note the need to consider the likely future use – for example if the demographic changes were the result of e.g., a one-off natural catastrophe they would likely not be representative, and thus it would be inappropriate to measure a school at a replacement value based on "temporary" demographic changes.

The Conceptual Framework also needs to address the impact of factors such as inflation etc. in selection of measurement bases. For example, whether historical cost might be a suitable measurement basis will be impacted by the degree to which a particular economy is affected by inflation.

Specific Matter for Comment 4

In your view, should:

a) *The effect of an entity's own credit risk be reflected in the measurement of liabilities at initial recognition; and*

b) *The effect of changes in own credit risk be reflected when liabilities are subsequently remeasured?*

The IDW does not support the arguments that this issue is of limited significance to the public sector (para. A2) and would like to refer to its comment on this issue to the IASB made several times in response to discussion papers and exposure drafts in recent years. The IDW does not see any public sector specific reasons that would alter its previously stated rejection of a general reflection of an entity's own credit risk in measurement of its liabilities. Indeed, in the current climate experienced in Europe, we believe that such reflection would be highly inappropriate.

We refer to our letter dated 24 July 2009 to the IASB, in which we pointed out three arguments against any reflection of an entity's own credit risk in measuring liabilities, which are briefly summarized as follows:

- Resultant gains are counterintuitive (they do not derive from an improvement in an entity's economic situation and may thus confuse users)
- Accounting mismatches between assets and liabilities may be increased (underlying declines in assets may not be evident in the financial statements)
- Realization of such changes may be only hypothetical (in many cases this will be the case as public sector entities report on the going concern assumption)

However, in this letter we also expressed the view that it is necessary to distinguish between obligations that are essentially exchanges for cash and those that are not. In the case of cash exchanges the credit risk will already have been taken into account on initial recognition (i.e., the price set takes account of the credit risk) but should not be reflected on re-measurement i.e., changes in that credit risk would not be reflected. Liabilities "held for trading" would be the exception to this. In contrast, for other obligations e.g., assets removal obligations on initial recognition, it would be appropriate to discount expected future cash flows at market rates that exclude the effect of credit risk, since managements future intentions would form the basis for expected future cash flows i.e., whether the liability will be fulfilled, transferred or settled, and subsequent discounting on re-measurements should use market rates that exclude changes in the entity's credit risk.

Specific Matter for Comment 5

In your view, where assets are not restricted in use and therefore may be sold for an alternative use, should the measurement reported in the statement of financial position reflect:

a) *Only the service potential relating to the existing use; or*

b) *Include the incremental value relating to its possible sale for an alternative use?*

In our view, it is not appropriate to seek a response to generalize this issue. Both measurements may provide useful information to financial statement users. However, the relevance for the statement of financial position will depend

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on the individual circumstances, including the entity's intent and ability to put the asset to alternative use or to sell it. The interaction between the two measurement bases and the qualitative characteristics identified in CP1 ought to be decisive factors. In the public sector context, even when assets are not restricted in use the entity may have an obligation to provide particular services and be using the particular assets to do so, such that the extent to which the entity's actual ability to put the asset to alternative use or to sell it could be seen as realistic would need to be taken into account. The CP would benefit from a wider discussion of this aspect as it relates to the public sector context.