

## **Comments and suggestions on the IPSASB Consultation Paper “Measurement”**

### **Task force IRSPM A&A SIG, CIGAR Network, EGPA PSG XII**

The IPSASB has requested comments and answers to specific questions regarding its Measurement Project. The comments and responses prepared by the Task Force IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are presented below.

The IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are three research networks that focus on Public Sector Accounting. The Task Force is made up of 18 researchers from these networks. The views expressed in this document represent those of the members of the Task Force and not of the whole research community represented by the networks, and neither of the Institutions/Universities with which they are affiliated.

#### **Core assumptions**

We are of the opinion that Public Financial Management (PFM), in its broadest sense, is the system by which public financial resources are planned, managed and controlled. Furthermore, the PFM system is the foundation on which the accountability of public sector entities, both external and internal, is built to enable and influence the efficient and effective delivery of public service outcomes and to discharge accountability towards citizens. In our view, PFM is paramount for accountability and should support the stewardship and decision-making functions, which are both subordinated. We recognize the pivotal role of the IPSASB in developing high quality international public sector accounting standards to support financial reporting and to enhance non-financial disclosure by public sector entities to increase citizens' trust.

We are of the opinion that, in general, public sector entities require public sector specific principles and standards that properly address and accommodate public sector specificities. As such, when public sector transactions resemble those taking place in the private sector, principles and standards may be kept as aligned as possible. However, for public-sector-specific transactions, we are in favour of standards that are not adapted artificially from private sector accounting and we think there is a need to seek options that best fit the public sector. This core thesis underpins our proposals and recommendations within which we have sought to embed issues raised in academic works.

## General comments on the Consultation Paper “Measurement”

We wish to state from the outset that it is not clear why the IPSASB considers it necessary to issue an IPSAS on measurement, rather than carry out an extensive review of Chapter 7 of the Conceptual Framework. “The Conceptual Framework establishes the concepts that underpin financial reporting, which the IPSASB applies in developing IPSAS” (par. 1, Consultation Paper – Measurement). The rationale of the Measurement Project is that “measurement requirements in IPSAS should be amended to better align them with the Conceptual Framework’s measurement concepts” (par. 3). The project should “focus primarily on developing guidance that is widely applicable and can be broadly applied throughout the IPSAS suite of standards” (par. 4). **So why not start with the Conceptual Framework and elaborate on the measurement concepts by providing better guidance?** In other words, the Conceptual Framework Scope Review that is proposed in pars. 17-19 of the Consultation Paper (page 12) should incorporate changes to the Measurement Chapter 7 according to the feedback received on this Consultation Paper. The Conceptual Framework could be supported with Reporting Practice Guidelines (RPGs) especially in view of the technicality involved with certain valuation techniques.

The Conceptual Framework should be complete in a way that the standards can be derived from it and that all standards are in line with it. Thus, the Conceptual Framework should be revised, resulting in a complete list of measures and a coherent measurement/valuation theory, to which the individual standards refer. This technique would ensure that the Conceptual Framework provides a robust foundation and contributes to the coherence of the IPSAS system. This procedure would prove to be a superior alternative to the development and release of a new standard that could (see below) include deviations as ad hoc exemptions from the Conceptual Framework, raising doubts whether the IPSAS represent a kind of patchwork carpet rather than a system.

The IPSASB’s Conceptual Framework refers to the possibility of further work at standards level in order to better align the chapter on measurement (Chapter 7) with the IASB’s standard on fair value (BC7.28). If this is the underlying reason for this ‘exhaustive’ consultation paper on measurement, perhaps the IPSASB should first carry out amendments to Chapter 7 of the Conceptual Framework in order to illustrate the concept of measurement in general and to guide users accordingly; and then re-consider the necessity to issue a standard that only deals with fair value. In this way, the Conceptual Framework can function as a conceptual underpinning by affecting future standards (Ellwood and Newberry, 2016)<sup>1</sup>. Our responses below reflect this position.

In our opinion, the IPSASB should revise the Conceptual Framework rather than issue a specific

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<sup>1</sup> Ellwood, S. and Newberry, S. (2016). The conceptual underpinnings of international public sector accounting. *Public Money & Management*, 36(3), 231-234

IPSAS on measurement. However, should the IPSASB still choose to issue an **IPSAS** on measurement, it should **revise the title** to clarify that it only covers the **measurement of assets and liabilities**. The consultation paper focuses on the valuation of assets and liabilities, which values are to be included in the statement of financial position. It does not deal with measurement of income and expenses because these elements are being covered in other consultation papers. The title of the ED/proposed standard should clearly state that it only deals with measurement of assets and liabilities. This clarification is important because the relevance of the balance sheet for accountability and decision making varies across types of public sector entities.

Indeed, it can be argued that measuring of assets and liabilities is interrelated to income/revenue and expense as changes in assets or liabilities influence surplus or deficit of a period. This argument supports the static view of accounting that focuses on balance sheet valuations at a certain point in time. This notion is important for entities that are profit-driven but is not suitable for public sector entities (Anthony, 1978<sup>2</sup>; Mautz, 1981<sup>3</sup>; Pallot, 1992<sup>4</sup>; Zavattaro & Anessi Pessina, 1994<sup>5</sup>; Biondi, 2012<sup>6</sup>, 2016<sup>7</sup>). For governmental-type units, that perhaps do not generate any income at all, or whose only source of income would be from non-exchange transactions, the value of the statement of financial position diminishes; in the sense that there is no relationship between assets in the balance sheet, the ability to generate revenue and the valuation of the entity per se. A balance sheet focus is inconsistent with the specificities of public financial management (Biondi, 2018)<sup>8</sup>. The operational and financial capacities of governmental-type units are assessed through their sovereign powers to raise taxes and collect fees, which would not be linked with any balance sheet item.

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<sup>2</sup> Anthony, N.R. (1978). *Financial accounting in non-business organizations. An exploratory study of conceptual issues, research report*. Norwalk, CT: Financial Accounting Standards Board.

<sup>3</sup> Mautz, R.K. (1981). Financial reporting: Should government emulate business? *Journal of Accountancy*, August, 53–60.

<sup>4</sup> Pallot, J. (1992). Elements of a theoretical framework for public sector accounting. *Accounting, Auditing & Accountability Journal*, 5 (1), 38–59.

<sup>5</sup> Zavattaro, F., & Anessi Pessina, E. (1994). Prime riflessioni sui sistemi di contabilità economica nel servizio sanitario nazionale [First insights on systems of accrual accounting for national health system]. *MECOSAN*, 10, 8–11.

<sup>6</sup> Biondi, Y. (2012). Should Business and Non-Business Accounting Be Different? A Comparative Perspective Applied to the New French Governmental Accounting Standards. *International Journal of Public Administration*, Volume 35, Issue 9, pages 603-619

<sup>7</sup> Biondi, Y. (2016). Governmental Accounting and Austerity Policies: Accounting Representations of Public Debt and Deficit in Europe and Abroad. *Accounting Forum*, Vol. 40, pp. 89-105.

<sup>8</sup> Biondi, Y. (2018). The Financial Sustainability Conundrum in Central Government. *Accounting, Economics and Law*. Doi: 10.1515/ael-2018-0003

## **Preliminary View 1—Chapter 2 (following paragraph 2.6)**

The IPSASB's Preliminary View is that fair value, fulfillment value, historical cost and replacement cost require additional application guidance.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons, stating clearly which measurement bases should be excluded from, or added to, the list, and why.

### **Response:**

In our opinion, additional application guidance is required for all measurement bases identified in the Conceptual Framework (refer to Figure 2.1), and not only for the most commonly used ones. The exclusion of certain measurement bases is not justified by this reasoning. Furthermore, by only considering the measurement bases used in past IPSAS, the result may once again be standards that only represent adaptations of IFRS and not standards that better reflect public sector features.

Fulfillment value, historical cost and replacement cost are already identified in the Conceptual Framework, with the details as described in Chapter 1 of this consultation paper.

Only fair value presents an issue because it is not mentioned in the Conceptual Framework as a measurement basis. The latter only deals with market value, reflecting the position of the IPSASB at the time that it was not in favour of an exit value-based definition of fair value. A similar reluctance was demonstrated by the UK's Financial Reporting Advisory Board (FRAB) in 2011, and the adoption of IFRS 13 to public sector tangible fixed assets featured during discussions until it was decided to apply IFRS 13 only to surplus assets, that is, those intended for sale on which there were no restrictions on sale (Hodges, 2016)<sup>9</sup>. This restricted use of fair value reflects how uncomfortable FRAB and the UK Treasury were with an extensive application of fair value. Still, it is proving difficult to classify assets in this way. The application of fair value to assets held for continuing use in the public sector represents a particularly difficult example of the 'estimation' of market value on which fair value is based.

Measurement of gains and losses in the valuation of assets, and differences between IPSAS and Government Finance Statistics (GFS), notably with respect to GFS' existing treatment of gains and losses (which are recognized as other economic flows) should be addressed in the guidance. However, we wish to emphasise that fundamental issues are raised by the application of fair value in public sector accountability. It is not just a matter of technical guidance, but conceptual incoherence with the public sector's specific missions and mode of functioning. We refer to case

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<sup>9</sup> Hodges, R. (2016). The conundrum of fair value measurement-evidence from the UK FRAB. *Public Money & Management*, 36(3), 227-230

studies on the French and UK Governmental Accounting elaborated in the literature (Biondi, 2012, 2016), which clearly showed the issues raised by a balance sheet approach and especially by fair value measurements in public sector entities. We also emphasise the problems raised by fair value and mark-to-market measurements in public debt assets and liabilities, for instance, imagine a government booking gains from: (a) the market devaluation of its current bond market price due to increasingly worrying perceptions of its risk of default; or (b) from revaluation on heritage and other non-available-for-sale assets.

We agree, therefore, that **additional application guidance is required for fair value**, and also that the confusion with market value should be clearly and concretely addressed. "Current value", "fair value" and "market value" are often used inter-changeably and their relationship to each other needs to be clarified (with a preference for consistently using one term for any given meaning) (Dabbicco, 2018<sup>10</sup>).

“Value in use” is another measurement basis that requires additional application guidelines<sup>11</sup>. Even though it applies specifically to impairment, it is still a measurement basis that is also included in the Conceptual Framework. If the IPSAS on Measurement (and/or the amended Conceptual Framework chapter) is to be comprehensive and exhaustive, then it should also include other measurement bases like “net realizable value” and “net selling price”, which are specific to inventories. The same applies to the “recoverable value” principle.

The **distinction** between a **measurement basis** and a **measurement technique** is not very clear (please refer to our response to SMC1). For example, par. 4.15(b) of the consultation paper (page 40) refers to “net realizable value” as a measurement basis. But Appendix C refers to it as a measurement technique. The same applies to “amortized cost”. Perhaps Appendix C should provide additional application guidance with regards to valuation techniques, like, “net realizable value” and “amortized cost”.

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<sup>10</sup> Dabbicco, G. (2018). A comparison of debt measures in fiscal statistics and public sector financial statements, *Public Money & Management*, 38(7).

<sup>11</sup> Again, in this context, only value in use from asset productive deployment (not from its marketability) should be included.

## **Preliminary View 2—Chapter 2 (following paragraph 2.6)**

The IPSASB's Preliminary View is that the application guidance for the most commonly used measurement bases should be generic in nature in order to be applied across the IPSAS suite of standards. Transaction specific measurement guidance will be included in the individual standards providing accounting requirements and guidance for assets and liabilities.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons, and state what guidance should be included, and why.

### **Response:**

Based on our response to PV 1, we find that, while the application guidance should be generic in nature, it should be provided for **all** measurement bases (and valuation techniques) that are mentioned in the IPSAS suite of standards, and not only for the most commonly used ones. Moreover, the IPSASB should be careful to develop guidance and new standards that better reflect public sector features, and not just adaptations of IFRS. Thus, the IPSASB should look beyond the measurement bases mentioned in IPSAS, and should also consider measurement practices developed by individual countries. Such governmental accounting practices would have been developed based on experience and would reflect how the difficulties of application in practice have been dealt with (see, for example, the UK case when dealing with fair value measurement [Hodges, 2016]).

In this way, the application guidance provided shall be exhaustive and practical. The individual IPSAS can then provide more specific guidelines in the form of examples from practice.

### **Preliminary View 3—Chapter 2 (following paragraph 2.10)**

The IPSASB’s Preliminary View is that guidance on historical cost should be derived from existing text in IPSAS. The IPSASB has incorporated all existing text and considers Appendix C: Historical Cost—Application Guidance for Assets, to be complete.

Do you agree with the IPSASB’s Preliminary View?

If not, please provide your reasons, stating clearly what you consider needs to be changed.

#### **Response:**

First of all, we wish to point out that the exercise of compiling Appendix C should assist the IPSASB to **update Chapter 7** of the Conceptual Framework in a comprehensive manner.

Appendix C is compiled by copying extracts from the Conceptual Frameworks of the IPSASB and the IASB, and from IPSAS 12, 16, 17 and 31. The guidance included in this appendix applies to a variety of assets, including inventory, investments, PPE, intangibles, and financial instruments.

It is a matter of opinion as to how helpful such a hotchpotch of information can be to users of the standards. In our opinion, the information copied from the individual IPSAS should not be deleted from the particular standards (as suggested in par. 2.10, Page 18) because this may result in the individual IPSAS not being so helpful as they would refer the user to yet another standard. Such **cross-referencing** from one source to another may put off the user and **reduce understandability**.

The guidance in Appendix C should be extended to also apply to **liabilities** because short-term payables (example, most trade payables) may be measured at the original invoice amount if the effect of discounting is not material. Furthermore, with respect to fulfilment of liabilities, B20 (Page 75) states that “an entity need not discount the value of the future outflow of resources if the entity expects the obligation to be settled within one year”. Historical cost is acceptable for measuring short-term liabilities<sup>12</sup>. Longer term debts and similar obligations would represent more difficult measurement issues.

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<sup>12</sup> We draw your attention to an apparent inconsistency in footnote 38 to Appendix C, which states that “This application guidance focuses on historical cost for assets, because the consultation paper’s flow chart for liability measurement indicates that historical cost is not applicable to the measurement of liabilities”. Diagram 4.2 (page 41) clearly shows that historical cost is the baseline measurement basis for all liabilities, provided that the settlement amount is certain and the timing is known.

## Preliminary View 4—Chapter 2 (following paragraph 2.16)

The IPSASB's Preliminary View is that fair value guidance should be aligned with IFRS 13, taking into account public sector financial reporting needs and the special characteristics of the public sector. The IPSASB considers Appendix A: Fair Value—Application Guidance, to be complete.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons, stating clearly what you consider needs to be changed.

### Response:

As stated in the introduction to our responses, the IPSASB should consider issuing an IPSAS on Fair Value instead of this proposed IPSAS on Measurement. If the IPSASB proceeds with an IPSAS on Measurement, it should consider issuing a **separate IPSAS on Fair Value**. The particular implications of the use of fair value merit a separate standard so that it is not confused with other measurement bases, since it raises unaddressed issues when applied in general and especially to public sector entities. Furthermore, Appendix A is the section of the proposed IPSAS that contains new information that has not been dealt with in other IPSAS (or has been dealt with, but requires clarification so as not to be confused with “market value”).

As already highlighted in our answer to PV 1, the UK has encountered practical difficulties when attempting to meld the requirements of IFRS 13 to suit the public sector context (Biondi 2016). Hodges (2016) describes the difficulties encountered by the FRAB when attempting to adapt the requirements of IFRS 13 to make it applicable to the public sector context. The UK Treasury found it necessary to amend its Financial Reporting Manual to limit the use of fair value measurement.

More generally, the application of fair value in a public sector context creates particular difficulties in its application to non-financial assets and to liabilities where there is no direct evidence of a market price from which fair value should be determined. Such difficulties seem to be compounded because IFRS 13 does not always distinguish clearly between ‘**measurement**’, which requires an observable attribute, and ‘**estimation**’, which relies upon a subjective extrapolation from observable data (Barker and McGeachin, 2013)<sup>13</sup>. In circumstances where there is no active market for the precise type of assets or liabilities being ‘measured’, the fair value approach may rely upon a hypothetical valuation, which does not exist and does not represent the institutional reality of public sector bodies (for a private sector perspective see Barker and Schulte, 2017)<sup>14</sup>. If there are problems with IFRS 13 in the private sector, the prospects of its application in a public sector setting are not very encouraging.

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<sup>13</sup> Barker, R. and McGeachin, A. (2013). Why is there inconsistency in accounting for liabilities in IFRS? An analysis of recognition, measurement and conservatism, *Accounting & Business Research*, 43(6), 579-604.

<sup>14</sup> Barker, R. and Schulte, S. (2017). Representing the market perspective: Fair value measurement for non-financial assets, *Accounting, Organizations & Society*, 56, 55-67.

The following are some examples in Appendix A that may present difficulties (in the sense that they would present a series of bones of contention when attempting to apply them to the public sector context):

- a) A18 – “A fair value measurement of a non-financial asset takes into account a market participant’s ability to generate economic benefits by using the asset in its *highest and best use* ...”. It is argued that the highest and best use for a non-financial asset in the public sector may be social and/or cultural and may not even involve economic benefits. This problem is acknowledged by the IPSASB (par. 2.23, page 20).  
In addition, the interpretation of the market participants’ perspective, through which “highest and best use” is determined, could be influenced by political reasons. Such situations may lead to fictitious values being used under Fair Value measurement (Barker and Schulte, 2017).
- b) A21 – requires an entity to measure the fair value of a non-financial asset assuming its highest and best use by market participants even if the entity does not intend to use the asset according to its highest and best use. We believe that this may be a rather misleading way to value public sector assets because of the ambiguous message that the valuation would be providing, which may have dangerous political and social consequences.
- c) A22 (ii) – requires the valuation of the non-financial asset to “include liabilities that fund working capital, but do not include liabilities to fund assets other than those within the group of assets”. In a public sector context, however, most often it would be difficult to identify liabilities in this way because borrowing is usually done to finance operations in a general way and not to finance a particular group of assets. For example, the French law forbids attaching taxation revenues to specific uses of collected funds. Also in Germany, by definition, the nature of taxes refers to the taxation object without any consequences for their use (this is the main difference between taxes and fees in Germany).
- d) A28 – requires that, on initial recognition, the difference between fair value and the transaction price is recognized in surplus/deficit (unless the particular IPSAS states otherwise). It may be argued that introducing such subjectivity, immediately at the point of recognition of an asset/liability, would cast a rather ‘shady’ doubt on the accountability of the reporting entity. Most often, this amount would not be realized or realizable, undermining the users’ need to understand and assess public sector entity financial sustainability.
- e) A42 onwards – refer to present value techniques, which would require the establishment of a discount factor. It may be argued that it is rather difficult and hazardous to establish an appropriate discount factor in the public sector context, in particular for more governmental-

type of entities. It raises unaddressed concerns with pro-cyclical effects and self-fulfilling prophecies that were experienced already in the private sector (Biondi, 2012).

The use of discount factors would introduce a high level of subjectivity, especially when measuring long-term liabilities like pension obligations, as illustrated by the UK case study (Biondi, 2016). In order to reduce such subjectivity, a discounting regulation was released in Germany, for the private sector, specifying the method which the German Bundesbank should apply when calculating discount rates for the valuation of pensions. In the public sector (Standards staatlicher Doppik, which can be applied on Federal [central] or state [Länder] Level), an institution has been set up to prescribe discount factors for provisions that are adjusted on an annual basis.

Such developments at country level make the requirement of IPSAS guidance more important for the sake of comparability.

- f) A89 – “An entity’s intention to hold the asset or to settle or otherwise fulfil the liability is not relevant when measuring fair value because fair value is a market-based measurement, not an entity-specific measurement.” Similar arguments as in (b) and (d) apply.

The valuation techniques mentioned in A37 and A38 are quite technical. Some examples to illustrate their application in a public sector context would be appreciated.

**It is very important for the IPSASB to clarify the definitions of “fair value” and “market value”.** As also acknowledged by the IPSASB (par. 2.12, Page 18), there should be only one definition of “fair value”, and the IPSASB should be clear about this from the start.

Par. 2.21, Page 19, states that “At present, the IFRS 13 definition of fair value is explicitly exit-based, while market value continues to be a neutral definition – either entry or exit”.

The scope of the ED refers to “market value less costs to sell” as another measurement basis (page 45, par. 3[b]). Therefore, market value is still relevant.

Paradoxically, the difference between the definitions of “fair value” (page 45) and “market value” (pages 46-7) seems to be that the latter refers to exchanges not carried out in a market.

Footnote 39 on page 83 refers to the “old” definition of fair value.

In our opinion, **this confusion needs to be dealt with in the Conceptual Framework by amending the definition of “market value” in order to focus on the entry aspect of the measure**, as suggested by the IPSASB (par. 2.24, page 20). **Furthermore, we encourage the IPSASB to issue a specific standard on fair value for the public sector, taking into consideration the UK experience (Hodges, 2016) in order to minimize the instances when fair value is used.**

Our response to SMC 1 refers to the problem identified in par. 2.17 (page 19) with regards to the cost approach, replacement cost and current replacement cost.

### **Preliminary View 5—Chapter 2 (following paragraph 2.28)**

The IPSASB's Preliminary View is that fulfilment value guidance should be based on the concepts developed in the Conceptual Framework, expanded for application in IPSAS. The IPSASB considers Appendix B: Fulfilment Value–Application Guidance, to be complete. Do you agree with the IPSASB's Preliminary View? If not, please provide your reasons, stating clearly what you consider needs to be changed.

#### **Response:**

First of all, we wish to point out that the exercise of compiling Appendix B should assist the IPSASB to **update Chapter 7** of the Conceptual Framework in a comprehensive manner.

Appendix B is compiled from extracts from Chapter 7 of the IPSASB Conceptual Framework, with certain elaborations. In our opinion, the elaborations should be considered for inclusion in the Conceptual Framework, taking into consideration the following comments:

- a) There appears to be a conflict between B9 and B10 about the least costly manner of settlement.
- b) With reference to B12, as we already pointed out, sometimes a public sector entity cannot act “in its own economic best interest”; therefore, this assumption may need to be revised.
- c) B19 should refer to IPSAS 19 (similar to B7).
- d) The subjectivity required to calculate the Risk Adjustment (B32-B37) may have a negative impact on the level of accountability and may give misleading notions about the fulfilment value of a liability due by a public sector entity to a private third party.

**Preliminary View 6—Chapter 2 (following paragraph 2.28)**

The IPSASB's Preliminary View is that replacement cost guidance should be based on the concepts developed in the Conceptual Framework, expanded for application in IPSAS. The IPSASB considers Appendix D: Replacement Cost—Application Guidance, to be complete. Do you agree with the IPSASB's Preliminary View? If not, please provide your reasons, stating clearly what you consider needs to be changed.

**Response:**

Appendix D is compiled from extracts from Chapter 7 of the IPSASB Conceptual Framework, with certain elaborations. In our opinion, the elaborations should be considered for inclusion in the Conceptual Framework, taking into consideration that the assumption that an entity acts in its own best interests does not always apply (D25). Sometimes an entity has to follow instructions issued by a higher-level governing body; or it may act for social, cultural and political interests rather than for economical reasons.

### **Preliminary View 7—Chapter 3 (following paragraph 3.28)**

The IPSASB's Preliminary View is that all borrowing costs should be expensed rather than capitalized, with no exception for borrowing costs that are directly attributable to the acquisition, construction, or production of a qualifying asset.

Do you agree with the IPSASB's Preliminary View?

If not, please state which option you support and provide your reasons for supporting that option.

#### **Response:**

We support the IPSASB's decision to move away from IFRS requirements in the case of borrowing costs, and to require that all borrowing costs are expensed. The stance takes into consideration the particular financing characteristics of public sector and government-like entities. The fundamental issue of intergenerational equity further justifies the expensing of borrowing costs. Furthermore, the requirement to expense all borrowing costs would lead to more comparability, better asset management and more accurate calculations of costs of services<sup>15</sup>.

The problem is that the capitalization of borrowing cost is standard practice in private sector project finance. It may prove difficult for the IPSASB to retain its position to expense borrowing costs because many jurisdictions allow these costs to be capitalised, either explicitly or by allowing a third party to develop the asset and include the borrowing costs within the final acquisition cost / transfer price. Indeed, it is possible that a government operates on behalf of somebody else (e.g. a local government on behalf of a central government) whereby "job order accounting" is necessary implying that borrowing costs should be allocated to that job or project. In American fund accounting, this project will be treated as a specific fund.

Therefore, given that IPSAS are international standards (and not just European), it may be argued that it would make sense to leave both **options** available because developing countries may have significant borrowing costs related to capital assets. **Expensing borrowing costs would be the preferred treatment**, but capitalisation may be allowed on the basis of materiality considerations.

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<sup>15</sup> Nevertheless, it has to be stressed that, for the calculation of the cost of services, there is no obvious reason for the values used to coincide with those of financial reporting. While referring to the same data sources, cost accounting and financial reporting do not have to use the data in the same way.

**Preliminary View 8—Chapter 3 (following paragraph 3.36)**

The IPSASB's Preliminary View is that transaction costs in the public sector should be defined as follows:

**Transaction costs** are incremental costs that are directly attributable to the acquisition, issue or disposal of an asset or liability and would not have been incurred if the entity had not acquired, issued or disposed of the asset or liability.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons, and provide an alternative definition for the IPSASB to consider.

**Response:**

Yes, we support this definition of transaction costs. It is the definition found in IPSAS 41, but slightly amended to apply to all types of assets and liabilities (not just financial ones).

**Preliminary View 9—Chapter 3 (following paragraph 3.42)**

The IPSASB’s Preliminary View is that transaction costs should be addressed in the IPSAS *Measurement* standard for all IPSAS.

Do you agree with the IPSASB’s Preliminary View?

If not, please provide your reasons and state how you would address the treatment of transaction costs in IPSAS, together with your reasons for supporting that treatment.

**Response:**

Based on our position regarding the IPSAS on Measurement, we are of the opinion that the definition of “transaction costs” should be **included in Chapter 7** of the IPSASB’s Conceptual Framework, to which the individual standards refer. This would ensure consistency in accounting for transaction costs.

**Preliminary View 10—Chapter 3 (following paragraph 3.54)**

The IPSASB's Preliminary View is that transaction costs incurred when entering a transaction should be:

- Excluded in the valuation of liabilities measured at fulfillment value;
- Excluded from the valuation of assets and liabilities measured at fair value; and
- Included in the valuation of assets measured at historical cost and replacement cost.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons and state how you would treat transaction costs in the valuation of assets and liabilities, giving your rationale for your proposed treatment.

**Response:**

Here we are referring to transaction costs incurred when entering into a transaction. In this situation, we agree with the IPSASB's Preliminary View.

By definition, fulfillment value and fair value should not include transaction costs, that is, initial transaction costs are ignored. This applies to instances when an asset is acquired and when a liability is incurred.

On the other hand, when acquiring an asset that is valued at historical cost or replacement cost, the transaction costs should be included (added) in the valuation.

### **Preliminary View 11—Chapter 3 (following paragraph 3.54)**

The IPSASB's Preliminary View is that transaction costs incurred when exiting a transaction should be:

- Included in the valuation of liabilities measured at fulfillment value;
- Excluded from the valuation of assets and liabilities measured at fair value; and
- Excluded in the valuation of assets measured at historical cost and replacement cost.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons and state how you would treat transaction costs in the valuation of assets and liabilities, giving your rationale for your proposed treatment.

#### **Response:**

Here we are referring to transaction costs incurred when exiting a transaction. Should these be included in the measurement of the asset/liability at initial recognition? We agree with the IPSASB's Preliminary View with some clarification.

For example, a government entity acquires an energy plant with an estimated life of 20 years, after which it would need to be dismantled at an extra cost. The question is whether to include this extra cost when measuring the value of the plant to include in the balance sheet at initial recognition. We agree with the IPSASB's view that the valuation of the asset should exclude (ignore) such a transaction cost.

The same would apply for a liability which would require, say, additional legal costs to be incurred when it is extinguished (unless the liability is measured at fulfillment value, which, by definition, would include such transaction cost in the valuation).

Since we are considering expected transaction costs (not incurred), then these would need to be accounted for according to IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. Regardless of how the asset or liability shall be measured during ownership, the transaction costs required in order to dispose of an asset or settle a liability would need to be at least disclosed because they are always relevant for the decision-maker. Therefore, while we agree that such transaction costs are not included in the valuation of the asset/liability, they would need to be accounted for as a separate line item, according to the requirements of IPSAS 19.

### Specific Matter for Comment 1—Chapter 2 (following paragraph 2.29)

Definitions relating to measurement have been consolidated in the core text of the Illustrative ED.

Do you agree that the list of definitions is exhaustive?

If not, please provide a listing of any other definitions that you consider should be included in the list and the reasons for your proposals.

#### Response:

The list of definitions could be improved by making a distinction between (a) measurement bases; (b) valuation techniques; and (c) other terms.

The list of definitions in the ED (par. 6 pp. 45-47) refers to the “income approach” and “market approach” as two valuation techniques. The ED should specify that these valuation techniques are related to fair value and are better explained in Appendix A.

The list of definitions in par. 6 includes the “**Cost approach**”, also known as the “current replacement cost”. Referring to this valuation technique as “cost approach” may be misunderstood as referring to “historical cost”. It may be better to refer to it as “**current replacement cost**”, and perhaps also integrate it with the definition for “replacement cost”. Furthermore, the “cost approach” as mentioned in Appendix A (A31, A39, A40) should also be called “current replacement cost”.

The “current replacement cost” is also mentioned in Appendix D, linking it with “market price” and “depreciated replacement cost” (page 92, par. D29, D30). Due to the reference made to it in the ED (page 50, par. 23), perhaps the definition of “depreciated market value” should also be included in the list of definitions. Are the two terms “**depreciated replacement cost**” and “**depreciated market value**” interchangeable?

The definitions for market value of assets and liabilities refer to “**an arm’s length transaction**”. Perhaps the list of definitions should, therefore, provide the definition of an “an arm’s length transaction” in a public sector context. It would be interesting to see how this term can be made relevant for the public sector context.

The ED (page 49) refers to “recoverability” (par. 16) and “amortized cost” (par. 19). Perhaps the definitions of “recoverable amount” and “amortized cost” should be included in the list of definitions.

### Specific Matter for Comment 2—Chapter 3 (following paragraph 3.5)

Guidance in International Valuation Standards (IVS) and Government Financial Statistics (GFS) has been considered as part of the Measurement Project with the aim of reducing differences where possible; apparent similarities between IPSAS, IVS and GFS have been noted. Do you have any views on whether the IPSASB’s conclusions on the apparent similarities are correct? Do you agree that, in developing an Exposure Draft, the IPSASB should consider whether the concepts of Equitable Value and Synergistic Value should be reviewed for relevance to measuring public sector assets (see Addendum B)?

#### Response:

Yes, we agree that the IPSASB should note similarities that are apparent between the three frameworks, but this does not mean that they need to be aligned by attempting to reduce these differences. These frameworks are different because they have different objectives. The professionals working with these frameworks need to work in sync so that they understand each other, but this does not mean that the frameworks should be identical. For example, IVS 2017 does not recognize the term “value in use” as a measurement basis<sup>16</sup>, when perhaps this is the most relevant measurement basis to value an asset in the public sector context. The fact that the IVS 2017 does not recognize the term, does not reduce the relevance of “value in use” in any way.

The description of “equitable value” on page 108 implies that it refers to transactions that are not carried out at arm’s length, since it reflects the interests of those parties. If this understanding is correct, it is not surprising that it is not used in a public sector context because the reporting entity may be accused of underhand transactions lacking in transparency. We would not encourage the IPSASB to pursue such a valuation.

When two or more assets are worth more when combined, the extra value is referred to as “goodwill” in accounting terms<sup>17</sup>. For well-established reasons, in the private sector, inherent goodwill is not accounted for unless purchased. For the same reasons, “synergistic value” need not be considered for relevance to measuring public sector assets. First of all, with regards to inherent valuations, it should be borne in mind that that governments can influence the value of their assets, for example, by changing legally the "status" of land for agricultural activities to land for building houses. Or vice versa, streets and houses can be demolished and become green areas. Secondly, in the UK public sector, even purchased goodwill was not accounted for (Biondi, 2016). In the UK, there was concern over the reorganization of public sector bodies giving rise to ‘business combinations’ (in IFRS 3 terminology) that could give effect to revaluing assets and introducing goodwill into public group accounts. The result was an accounting regulation that dealt with the combination of public sector bodies that are not at arms-length to each other. This applies to most

<sup>16</sup> In our opinion, “value in use” is not the same as “investment value” as defined in IVS 2017.

<sup>17</sup> It is called “positive synergy” in Germany.

public sector reorganisations. Two different accounting treatments are identified, neither of which has the impact of acquisition accounting:

- (a) Transfer by merger effectively uses merger accounting. There is no revaluation of assets and liabilities, no goodwill and the bodies are treated as always having been part of the same group using the same accounting policies.
- (b) Transfer by absorption. There is no revaluation of assets or liabilities; there is no goodwill; and the bodies are treated as having been part of the same group from the date of the reorganisation (which means prior periods do not have to be adjusted).

For a slightly more detailed explanation see UK Treasury Financial Reporting Manual 2019-20 pp. 11-13.

### Specific Matter for Comment 3—Chapter 4 (following paragraph 4.21)

Do you agree that the measurement flow charts (Diagrams 4.1 and 4.2) provide a helpful starting point for the IPSASB to review measurement requirements in existing IPSAS, and to develop new IPSAS, acknowledging that other matters need to be considered, including:

- The Conceptual Framework Measurement Objective;
- Reducing unnecessary differences with GFS;
- Reducing unnecessary differences with IFRS Standards; and
- Improving consistency across IPSAS.

If you do not agree, should the IPSASB consider other factors when reviewing measurement requirements in existing IPSAS and developing new IPSAS? If so, what other factors? Please provide your reasons.

#### Response:

Even though diagrams tend to present an over-simplification of complicated issues, the two diagrams are helpful for their purpose, provided that **Chapter 7 of the Conceptual Framework is improved** in line with the comments received on this consultation paper.

If the “other matters” referred to are indicative of a prioritization process, we would suggest the following order:

- The Conceptual Framework Measurement Objective;
- Improving consistency across IPSAS;
- Reducing unnecessary differences with GFS; and
- Reducing unnecessary differences with IFRS Standards.

We have the following comments to make on Chapter 4 of this Consultation Paper.

We agree with the stance taken by the IPSASB as to how to deal with fair value, as described in footnote 29 (page 35). In its evaluation, the IPSASB should take into consideration the discussions and issues that have already been highlighted by the UK FRAB in its attempt to adapt IFRS 13 for the public sector context.

With reference to Diagram 4.1, this starts from the premise that an asset is held either for financial or operational capacity. Par. 4.11 (page 38) explains that assets held for their operational capacity are held to support the provision of services. The IPSASB should clarify whether “provision of services” includes assets held for social/cultural value or whether such assets fall into a different category. For example, would assets that are kept for specific legally defined purposes, e.g. stolen property of which the government becomes the owner after a period of time or other goods with restricted possibilities, be classified as “operational”? Or would they be another category of assets requiring different measurement criteria?

Par. 4.14 refers to “amortized cost” and “net selling price” (or “net realizable value”, as indicated in footnote 33) as alternative measurement bases/techniques. Costs of sale are also transaction costs related to the disposal of an asset. “Net selling price” is, therefore, the same as “market price less transaction costs” (costs to sell), which is referred to as a measurement basis for determining the current value of an asset in par. 4.15(b). This further supports our view that such bases should be covered by the proposed standard (or the Conceptual Framework, as we suggest). More importantly, the **various synonyms in use highlight the need for the IPSASB to align its terminology** in order to be more straightforward and understandable.

As already indicated, further application guidance is also required about “value in use”. Par. 4.15(b) (page 40) defines this as “the present value to the entity of the asset’s remaining service potential ...” The difficulty to measure service potential has already been recognized. In order to avoid misunderstanding, the definition should refer to “replacement cost” or “current replacement cost” that can be used as a proxy.

Par. 4.15(a) (page 40) states that “assets measured at historical cost provide information that indicates the entity expects the asset has the ability to generate sufficient economic benefits and service potential at least to recover the cost of the asset”. We wish to point out that such an expectation may in fact be rare in a public sector context because it goes against the non-profit motive that underlies governmental activity. The recovery of resources absorbed by an operation is the mentality of business enterprises focusing on wealth creation (Biondi, 2012).

## Conclusion:

We appreciate the effort done by the IPSASB to prepare a draft ED in conjunction with the Consultation Paper. This process gives a clear picture of the intentions of the IPSASB. Hopefully, it does not indicate that the ED is *fait accompli*.

With regards to the Measurement Project, basically, we cannot understand the objective of preparing a specific IPSAS on Measurement. The conceptual level of the arguments included in the consultation paper imply that **Chapter 7 in the Conceptual Framework should updated**, so that the individual IPSAS are then aligned accordingly. In our opinion, the IPSASB should use the responses to this Consultation Paper on Measurement to update the Conceptual Framework so that it can function as a basis to which the IPSAS can refer. Subsequently, the IPSASB should revise existing IPSAS so that measurement issues are consistent with the Conceptual Framework. If necessary, the IPSASB **can then consider the preparation of an IPSAS on *Fair Value for the Public Sector***, which would be the IPSASB's response to the IASB's IFRS 13.

In the process, we re-iterate that the IPSASB should:

- (a) undertake a consolidated effort to clarify and synthesize the terminology used throughout the Conceptual Framework and the individual IPSAS. In other words, the IPSASB should seek to remedy the current situation where different terms are used inter-changeably because this is having a negative impact on the understandability of IPSAS.
- (b) Take into consideration government accounting practices that have been developed to date because these reflect the difficulties encountered in application. This would be in line with the IPSASB's strategy to enhance comparability on an international level.

Finally, should the IPSASB proceed with the issue of an IPSAS on Measurement, we would like to point out that perhaps the scope should be limited to **exclude combinations and transfers**; that is, the proposed IPSAS should not include the impact of combination of entities, giving rise to mergers and acquisitions etc.

Date: 2 October, 2019

Signed on behalf of the (18) persons listed below

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