XRB
EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

18 September 2019

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Submitted to: www.ifac.org

Dear John

Consultation Paper, *Measurement*

Thank you for the opportunity to comment on the Consultation Paper, *Measurement* (the CP). The CP has been exposed in New Zealand and some New Zealand constituents may comment directly to you.

This letter identifies a number of issues which we think require further consideration by the IPSASB. We appreciate the IPSASB's commitment to the ongoing development of measurement concepts and their application and acknowledge that these issues are not easy.

The measurement project builds upon the IPSASB's ground-breaking work in developing Chapter 7 of the IPSASB's Conceptual Framework.[1] We appreciate that it takes time and effort to take the new ideas in a conceptual framework and apply them to standards. In addition, both the IPSASB and the IASB have continued to refine their views on measurement concepts and the application of measurement concepts in particular standards. This adds to the richness of measurement debates but it also adds to the challenge of developing measurement guidance that is consistent with an existing conceptual framework, or identifying what has changed since the framework was developed.

Notwithstanding our comments about the need to spend more time on some issues, we agree that in some instances it could be helpful to develop application guidance on measurement bases. This could include leveraging the work of the IASB where appropriate.

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1 *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, 2014. Also referred to as the Conceptual Framework in this letter.

We acknowledge the effort that has gone into this project and wish the IPSASB well as it progresses the project.

More conceptual thinking required

In our view, the IPSASB needs to prioritise work on its limited-scope review of the Conceptual Framework. One of the measurement project's stated objectives is to better align IPSAS with the Conceptual Framework. We do not think the IPSASB can meet this objective without first deciding what changes, if any, are required to the measurement chapter in the Conceptual Framework.

This need for more work is illustrated by the following proposals in the CP.

- The CP proposes to identify fair value, as defined in IFRS 13 *Fair Value Measurement*, as a measurement basis. This contrasts with the IPSASB's previous views. The IPSASB deliberately chose not to identify fair value as a measurement basis in its Conceptual Framework issued in 2014. The CP (paragraph 2.17) indicates that the IPSASB plans to address the challenge of incorporating fair value into IPSAS as part of its Conceptual Framework Limited-Scope Review project. We think that the IPSASB needed to address this matter first, before proceeding to develop a measurement standard. It is not clear why the IPSASB has changed its views on this matter, what this means for market value (being the measurement basis discussed in the Conceptual Framework) and what the implications will be on individual IPSAS that require or permit a current value measurement basis.

- The CP proposes to adopt much of the guidance in IFRS 13, including the guidance dealing with the use of the cost approach (also referred to as current replacement cost) as a valuation technique to estimate fair value. It also proposes to provide guidance on replacement cost as a separate measurement basis. If the IPSASB decides that fair value, as defined in IFRS 13, should be acknowledged as a measurement basis appropriate for IPSAS and supported by application guidance, the IPSASB will need to give more detailed consideration to a number of matters. It will need to differentiate between the use of the cost approach under fair value and replacement cost as a separate measurement basis, outline its views on when each would be appropriate and indicate how it intends to give effect to these views in standards, particularly in relation to the revaluation model in IPSAS 17 *Property, Plant and Equipment.* The CP (paragraph 2.17) does acknowledge that the IPSASB needs to further develop the relationship between replacement cost as a measurement basis and replacement cost as a measurement technique. We believe this work should have been done first and needs to be done before any guidance is finalised.

- The CP proposes to update the term *cost of fulfilment* currently applied in the IPSASB Conceptual Framework with *fulfilment value.* The CP states that this is to align with the terminology used in the IASB 2018 Conceptual Framework. Our view is that this is not merely a change in terminology. The illustrative ED proposes that *fulfilment value* should include a risk premium (also referred to as a risk adjustment). Although, the IPSASB Conceptual Framework is silent on this matter, the Basis for Conclusions on IPSAS 42 *Social Benefits* states that *cost of fulfilment* does <u>not</u> include a risk adjustment. The appropriateness of including a risk margin for the liabilities of public sector entities has been the subject of much debate in New Zealand. We think the IPSASB needs to consider in more detail whether it wants to adopt a measurement basis that includes a risk premium, why a risk premium is (or is not) appropriate, how the risk premium should be calculated (in general terms) and any implications for existing standards.

Standards should not drive changes to a conceptual framework

The CP states that the proposed standard will focus on the measurement bases commonly used in IPSAS. This approach gives rise to a number of risks. There is a risk that current requirements rather than conceptual thinking will drive changes to the Conceptual Framework and the proposed measurement standard might be given undue prominence in setting standards-level requirements. Conceptual frameworks should guide debates during the development of standards. If recent projects have led the IPSASB to conclude that it disagrees with aspects of its Conceptual Framework we would like to see those issues outlined and debated.

Risk of unnecessary changes to standards based on IFRS® Standards

The IPSASB is proposing to develop a measurement standard that contains guidance on a number of measurement bases. We think this approach runs the risk of making unnecessary changes to some standards for little or no benefit as well as the risk of inadvertently changing meaning. This is especially so in the case of historical cost guidance in IPSAS, much of which is specific to the transactions and balances dealt with in those standards.

This proposal could also lead to unnecessary differences between IFRS Standards and IPSAS. This difference could impact on mixed groups that also include entities reporting under IFRS. Also, alignment with IFRS Standards allows constituents to draw upon the body of knowledge that has developed in support of those standards. We have concerns that even minor changes, which are not intended to create differences between the suites of standards, could lead preparers to think that there is an intentional difference and query the appropriateness of related IFRS guidance. We acknowledge that there are instances in which public sector specific changes may be warranted, but we cannot see any public sector specific reason for relocating or revising some measurement guidance.

Illustrative ED approach

The IPSASB has trialled a new approach with this CP and included an illustrative ED. The IPSASB hoped that this approach would provide constituents with a clearer view of the IPSASB's direction of travel, by showing how the ideas in the CP could be reflected in a draft IPSAS. We appreciate the IPSASB's intentions, but have not found this approach to be helpful. We would have found it more helpful if the IPSASB had developed a consultation paper in the usual way. We believe this approach has led to the omission of some important first steps, including undertaking the conceptual thinking we have highlighted above and consulting on these matters.

In addition, the partial nature of the illustrative ED has made it difficult to comment on the guidance. The amendments to other standards are critical to forming a view on the appropriateness of the measurement bases selected and the appropriateness and completeness of the proposed application guidance. A Basis for Conclusions is also essential for commenting on an ED.

Scope of the project

The *Project Overview* section of the CP notes the desirability, to the extent possible, of aligning measurement guidance with IFRS Standards, International Valuation Standards and Government Finance Statistics. We note that accounting standards are often applied in conjunction with the assistance of actuaries and suggest that the IPSASB also liaise with the International Actuarial Association.

The IPSASB has stated that it will not be considering amendments to the impairment standards in this project. Because the impairment standards refer to various measurement bases and approaches (including fair value and depreciated replacement cost) we think that these standards would need to be amended to be consistent with the proposed measurement standard.

Experience in applying IFRS 13

Although IFRS 13 *Fair Value Measurement* was developed for application by entities applying IFRS Standards, the majority of which have a profit objective, public sector entities in some jurisdictions, such as Australia and the United Kingdom, have also been required to apply IFRS 13 or equivalent requirements to certain assets. The way in which the relevant assets have been specified, the implementation issues encountered and the response of standard setters to those issues could inform discussions as the IPSASB moves forward with this project.

If you have any queries or require clarification of any matters in this letter, please contact Joanne Scott (joanne.scott@xrb.govt.nz) or me.

Yours sincerely

Kimberley Crook

Chair – New Zealand Accounting Standards Board

APPENDIX

Responses on Preliminary Views and Specific Matters for Comment

We have responded to PVs 1 to 7, SMC1 and SMC3. To the extent that we have commented on the PVs and SMCs, we have thought about the needs of public benefit entities (PBEs) in New Zealand, including both public sector and not-for-profit entities such as charities. We have referred solely to public sector entities in a few places – this is because we have more information about the views of public sector entities on certain issues.

Preliminary View 1—Chapter 2 (following paragraph 2.6)

> The IPSASB's Preliminary View fair value, fulfillment value, historical cost and replacement cost require additional application guidance.
>
> Do you agree with the IPSASB's Preliminary View?
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> If not, please provide your reasons, stating clearly which measurement bases should be excluded from, or added to, the list, and why.

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.

We have combined our responses to PV1 and PV2.

We have serious reservations about developing additional application guidance for measurement bases without having first thought through the application of the Conceptual Framework to the measurement of particular transactions and balances, and determined what this means for particular standards and whether any changes are required to the Conceptual Framework. Until the IPSASB has done this work, we are unable to agree with PV1 and PV2.

The IPSASB has indicated that it intends to undertake a Conceptual Framework Limited-Scope Review project. We think that this project needed to come first.

The proposed focus on the most commonly used measurement bases carries a risk that current requirements will drive the IPSASB's future decisions in determining an appropriate measurement basis, overshadowing the Conceptual Framework. Conceptual frameworks should guide debates during the development of standards. If recent projects have led the IPSASB to conclude that it disagrees with aspects of its Conceptual Framework we would like to see those issues outlined and debated. For example, we think the IPSASB needs to explain to constituents why the IPSASB chose to identify market value rather than fair value as a measurement basis in the Conceptual Framework and the IPSASB's views about how market value should be reflected in standards. If the IPSASB has since decided that fair value is an appropriate measurement basis for IPSAS, then we think the IPSASB should explain to constituents when and how it thinks fair value rather than market value should be used in standards and how it plans to explain the relationship between fair value and market value in the Conceptual Framework. Or, if the IPSASB decides to remove market value from the Conceptual Framework, it needs to explain to constituents which aspects of its previous thinking have changed.

Our key point is that the IPSASB needs to give further consideration to the measurement bases that it thinks should be outlined in the Conceptual Framework and its views on when those bases should be used. Only then will the IPSASB be in a position to decide what guidance is required at standards level and whether some of that guidance should be included in a general measurement standard.

If the IPSASB decides to proceed to develop a measurement standard we have a number of concerns about the proposed application guidance – both in relation to location and content. These concerns are as follows.

(a) There is a risk that the proposed measurement standard will inappropriately stray into Conceptual Framework territory. It also runs the risk of inappropriately limiting future standards-level discussions or conflicting with current standards. For example, the IPSASB's views on the appropriateness of a risk premium in current value measures for liabilities needs to be thought through before developing any generic guidance. If the IPSASB considers that a risk premium might not be appropriate in some instances, then both the measurement bases identified and any generic guidance relating to that measurement basis should reflect this. The review of the Conceptual Framework needs to occur before, or at the same time as the development of the measurement standard, to make sure that the guidance is both appropriate and appropriately located.

(b) We are not convinced that all measurement application guidance belongs in one standard. Some of the existing guidance in IPSAS is transaction specific and would sit better in specific standards than in generic guidance. For example, we do not support the development of generic guidance on historical cost.

If the IPSASB's subsequent work on conceptual issues results in the conclusion that fair value, as defined by the IASB, is an appropriate measurement base to use in certain IPSAS (for example, the financial instrument standards), we agree that general application guidance on fair value would be useful. This would have the advantage of bringing additional guidance from IFRS 13 *Fair Value Measurement* into IPSAS and lead to better alignment between the discussion of fair value in IPSAS and IFRS Standards.

If the IPSASB decides to proceed with a general measurement standard (rather than developing an IPSAS that is equivalent to IFRS 13), we think the following two conditions could be used to identify application guidance that is appropriate for inclusion in a general measurement standard. The conditions are that the application guidance is:

(a) public sector specific; and

(b) sufficiently generic that it can be used in more than one standard.

Application guidance on the replacement cost of non-cash-generating assets is an example of guidance that is both public sector specific and can be used in more than one standard. It is relevant to both IPSAS 17 *Property, Plant and Equipment* and IPSAS 21 *Impairment of Non-Cash-Generating Assets*.

Application guidance on historical cost would not meet these conditions because there is little or no generic application guidance needed. We believe that much of the current application guidance on historical cost is best located in individual standards.[2] In addition, moving guidance on historical costs from individual standards to a general measurement standard would result in unnecessary changes to IPSAS and potentially unnecessary differences between IPSAS and IFRS Standards.

As discussed elsewhere in our comment letter, the proposed guidance on fulfilment cost/value needs further consideration. We do not believe that changing the term *cost of fulfilment* to *fulfilment value* is merely a change in terminology. The IPSASB needs to determine the appropriateness of a risk premium for the public sector before developing guidance on measurement bases.

General comments on PVs 3 to PV6

We have three general comments on PV3 to PV6.

(a) We do not understand why the IPSASB is seeking feedback about whether the draft appendices are *complete*. We think it would have been more appropriate to focus on whether constituents agree with the proposed guidance, with completeness being a secondary matter.

(b) Constituents would need to see the Basis for Conclusions on the proposed application guidance to provide informed comments.

(c) We cannot fully consider the usefulness of generic guidance on particular measurement bases without knowing more about when and how that guidance will be referred to in standards. Our views on the generic descriptions and the need for guidance on those bases could well be influenced by how these bases are applied in standards. Taking property, plant and equipment as an example, depending upon the type of asset and the purpose for which that asset is held, historical cost, fair value (as per IFRS 13) or replacement cost might be appropriate for different assets.

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.

As noted in our comments on PV1 and PV2 we do not support the development of generic guidance on historical cost. In this case we think that the guidance is better located in individual standards. If

[2] This point is illustrated by paragraphs C15 and C17 on historical cost in the illustrative ED which clearly relate to property, plant and equipment rather than inventory.

the current guidance on historical cost were to be rewritten in the form of general guidance and transaction specific guidance, there is a risk of making inadvertent changes. However, it would be worthwhile to consider whether the existing guidance in various standards is consistent.

We note that the treatment of borrowing costs is an historical cost issue and that the discussion of historical cost should have included the borrowing cost discussion. Recent debates about which costs to include in the measurement of liabilities could also have been considered as part of a broader historical cost discussion.

We disagree with the IPSASB's assertion that historical cost is not applicable to liabilities (as per the footnote 38 to Appendix C, shown below). Historical cost is a possible measurement basis for liabilities, with some liabilities being measured at amortised cost. As noted in an AASB occasional paper (2013),[3] many liabilities do not have historical proceeds but, if the amounts of the proceeds attributable to a liability are clearly evident and the amount reflects the characteristics of the liability, historical cost could be a reasonable surrogate for exit-price or entity-specific value. The assertion that historical cost is not applicable to liabilities also seems inconsistent with Diagram 4.2 *Subsequent Measurement: Liabilities* which suggests that the IPSASB will consider historical cost as a measurement basis for liabilities.

> **Extract from CP, footnote 38 to Appendix C**
>
> 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. It does not address depreciation, amortization and impairment, because previous IPSASB decisions have indicated that these should be addressed in other IPSAS, rather than IPSAS, *Measurement*.

Preliminary View 4—Chapter 2 (following paragraph 2.16)

> The IPSASB's Preliminary View is 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.

To the extent that, having done more conceptual thinking about how fair value sits within the Conceptual Framework and when it is appropriate within standards, the IPSASB decides that some IPSAS should require the use of fair value as defined in IFRS 13, fair value guidance aligned with IFRS 13 would be helpful for constituents. As noted earlier, in order to provided informed feedback on proposed fair value guidance we would need to understand how the IPSASB plans to incorporate fair value in the Conceptual Framework and the proposed amendments to standards.

If the IPSASB proceeds to issue application guidance on fair value, it will need to decide how to clearly differentiate between the use of the cost approach to determine fair value and replacement cost as a separate measurement basis. There is a risk of constituents being confused about the use of replacement cost in two contexts. Appendix A (paragraph A39) refers to current replacement cost in the discussion of the cost approach to determining fair value and Appendix D is about

[3] AASB Occasional Paper No. 1 *Liabilities – the neglected element: a conceptual analysis of the financial reporting of liabilities*, Warren J McGregor, Principal author, 2013

replacement cost as a measurement basis in its own right. Although these two terms are very similar they are talking about quite different measures. The cost approach in Appendix A has a different measurement objective to replacement cost as a measurement basis. Different terminology might be one way of avoiding confusion. The IPSASB will also need to clearly indicate in standards when they are referring to replacement cost as a separate measurement basis.

Addendum C of the CP shows that the IPSASB has not included the IFRS 13 guidance on non-performance risk (paragraphs 42 to 45 of IFRS 13) in the illustrative ED. Addendum C indicates that this guidance is potentially to be included in IPSAS 41 *Financial Instruments*. In the absence of a Basis for Conclusions outlining why the IPSASB has decided not to include such guidance in the illustrative ED and the IPSASB's views about the impact of omitting such guidance from the proposed measurement standard, we cannot form a view on whether this omission is appropriate.

Preliminary View 5—Chapter 2 (following paragraph 2.28)

The IPSASB's Preliminary View is that fulfillment value guidance should be based on the concepts developed in the Conceptual Framework, expanded for application in IPSAS. The IPSASB considers Appendix B: Fulfillment 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.

We are unable to agree with the IPSASB's proposal to switch from *cost of fulfilment* to *fulfilment value* as a measurement basis as the CP has not explored the implications of this change. The CP states that the change in terminology is to align with the terminology used in the IASB 2018 Conceptual Framework. However, the proposals in the CP reflect more than a change in terminology and needed more in-depth consultation.

Fulfilment value, as described in the IASB 2018 Conceptual Framework, includes a risk premium. The risk premium (for a liability) is described as being "the price for bearing the uncertainty inherent in the cash flows". Paragraph 6.20 of the IASB 2018 Conceptual Framework clarifies that in the case of fulfilment value the risk premium is determined from an entity-specific perspective whereas in the case of fair value it is determined from a market-participant perspective.

Appendix B of the CP indicates that the fulfilment value of a liability is to include a risk premium (see paragraphs B12–B13 and B37 shown below – emphasis added).

> B12. The fulfillment value is an entity specific value. An entity shall measure the fulfillment value of a liability using the assumptions from the entity's perspective, assuming the entity acts in its own economic best interest.
>
> B13. In developing those entity-specific assumptions, an entity shall identify characteristics specific to the entity and the liability, considering factors specific to all the following:
>
> (a) The liability;
>
> (b) The entity's expectations about the amount and timing of future outflows of resources;
>
> (c) The time value of money; and
>
> (d) The risk that the actual outflow of resources may ultimately differ from those expected (i.e., a risk premium).
>
> …

B37. An entity shall apply judgement when determining an appropriate risk adjustment technique to use. If a risk premium were not included, the measurement would not faithfully represent the cost to fulfill the liability. In some cases determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is not a sufficient reason to exclude a risk premium.

This contrasts with the description of cost of fulfilment in the IPSASB Conceptual Framework which does not mention a risk premium. It also conflicts with the Basis for Conclusions on IPSAS 42 *Social Benefits* (see paragraph BC152 shown below) which states that *cost of fulfilment* does <u>not</u> include a risk adjustment.

BC152. The IPSASB sought the views of respondents to the CP regarding a risk adjustment. Respondents generally considered that the cost of fulfillment measurement basis, which does not include a risk adjustment, was the most appropriate measurement basis for social benefits.

Given that the inclusion of a risk premium or risk adjustment in liability measures has been a much-debated topic in the public sector, the IPSASB needs to critically assess whether it wants to adopt a measurement basis that includes a risk premium, why a risk premium is appropriate, and from whose perspective the risk premium should be calculated.

Any change in the IPSASB's views about the appropriateness of a risk premium in an entity-specific liability measure would be a significant change that should be highlighted in due process documents.

In addition to wanting to know why the IPSASB is proposing to make this change, we would need to see the proposed amendments to other standards that could be affected by this change, such as IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* and IPSAS 39 *Employee Benefits*, before we could comment on the appropriateness of this guidance.

On a more detailed note, the proposed definition of risk premium in the CP is appropriate for fair value, but not for fulfilment value. Both fulfilment value and fair value require consideration of a risk premium, albeit from different perspectives.

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.

Replacement cost is being used in two contexts

The IPSASB needs to consider more fully how it will clarify what it means by replacement cost as a measurement basis, how this differs from the use of current replacement cost (the cost approach) in estimating fair value and when each is appropriate. We would need to know the IPSASB's views on these matters before we could comment on the appropriateness of the proposed guidance on replacement cost.

In both cases an entity would be using cost information to arrive at a measure for financial reporting, but the measurement objective would determine what costs should be included. IFRS 13 has a specific measurement objective – it discusses the use of the cost approach as a method to estimate fair value as defined in IFRS 13 (which is from the perspective of a market participant seller). Moreover, IFRS 13 is focused on the price that a market participant would be willing to pay to acquire the cash-generating-capacity of the asset, rather than its potential to provide public services (i.e. its service potential).

In summary, in order to apply the measurement requirements in IPSAS, constituents will need to know whether the measure is an entry or exit measure and whether it is intended to be entity specific or have a market participant focus. They also need to know whether to focus solely on an asset's potential to generate cash flows or whether to consider an asset's service potential. The distinction between assets held mainly for cash generation and assets held mainly for service potential may be one way of determining when the cost approach (as a method of estimating fair value) versus replacement cost (as a distinct and different measurement basis) are appropriate.

Comments on using DRC to estimate fair value (as currently defined in IPSAS)

IPSAS 17 permits the use of depreciated replacement cost as a means of estimating the fair value of an asset. When the NZASB introduced PBE IPSAS 17 *Property, Plant and Equipment* it noted that public benefit entities in New Zealand frequently use depreciated replacement cost to estimate the fair value of property, plant and equipment, including infrastructure assets. The NZASB noted that neither IPSAS 17 nor IPSAS 21 *Impairment of Non-Cash-Generating Assets* provide guidance on this topic at the level of detail previously provided in NZ IAS 16 *Property, Plant and Equipment*. The NZASB included additional application guidance on this topic in order to enhance the consistency of asset valuations in financial statements.[4] That guidance addressed specific issues that had arisen in practice.

In our view the application guidance that accompanies PBE IPSAS 17 more clearly addresses some of these issues than the proposed guidance in Appendix D. For example, Appendix D doesn't appear to cover the situation where the entity has to do extensive work to get land into a condition suitable for use and that use is specialised. We also note that paragraph D5 refers to "the current value of the existing site" but it isn't clear whether this is (i) the value of the current site, based on the current use or (ii) the highest and best use of that site. The additional guidance in PBE IPSAS 17 drew upon international valuation guidance available when PBE IPSAS 17 was developed.

In the interests of developing guidance that works internationally and is consistent with the international valuation standards, we encourage the IPSASB to continue to work with the International Valuation Standards Council.

[4] PBE IPSAS 17 is available on the XRB's website here

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.

We do not agree with PV7. We acknowledge that it is common practice in the public sector, including the public sector in New Zealand, to expense borrowing costs. We also acknowledge that public sector entities borrow for purposes other than financing the construction of assets and could experience difficulties in identifying and allocating borrowing costs, over and above the difficulties experienced by large private sector groups applying IAS 23 *Borrowing Costs*.

However, we do not consider that the IPSASB has presented sufficiently strong arguments to eliminate the option in IPSAS 5 to capitalise certain borrowing costs. We note the following.

- There are conceptual arguments in support of capitalising borrowing costs. One can argue that if an entity has borrowed to finance the construction of an asset, including the borrowing costs during the period of construction gives a faithful representation of the cost of the asset.
- The argument that expensing borrowing costs leads to more comparable measurement of assets works in relation to self-constructed assets. However, expensing can lead to less comparable measurement of purchased versus constructed assets.
- Not all public sector entities experience the difficulties encountered by larger governments.
- Retaining the option would allow those entities that form part of mixed groups to select accounting policies that are consistent with IFRS Standards.
- Private sector preparers and users have expressed divergent views on the two options.[5] More research on the views of public sector preparers and users (including views about the importance of transparent reporting of total interest expense) would inform debates on this issue.

In our view, mandating the treatment of borrowing costs on initial measurement does not address the issue of what costs should be included in assets measured at fair value using the cost approach nor what costs should be included in a replacement cost measurement. Given the prevalence of depreciated replacement cost valuations in some jurisdictions this is an important issue. In the case of current value measures, the costs that are included depend upon the measurement objective. More guidance on the extent to which financing costs should be included in such valuations is required. We would encourage the IPSASB to work with the International Valuation Standards Council on this issue.

We also note that negative interest rates are becoming more prevalent and suggest that any work on the treatment of interest encompass this possibility.

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[5] European Commission (May 2008), Endorsement of IAS 23 *Borrowing Costs*, Effect Study – Report https://ec.europa.eu/info/sites/info/files/ias23_effect_study_en.pdf

Preliminary View 8—Chapter 3 (following paragraph 3.36)

Preliminary View 9—Chapter 3 (following paragraph 3.42)

Preliminary View 10—Chapter 3 (following paragraph 3.54)

Preliminary View 11—Chapter 3 (following paragraph 3.54)

We have not commented on Preliminary Views PV8 to PV11.

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.

Given our earlier comments about the need for more work before proceeding with this ED, we are not commenting on SMC1 at this point.

When the IPSASB next seeks comments on proposed definitions for a measurement standard we recommend that it asks whether the definitions are appropriate, rather than exhaustive. We note that some of the definitions (for example, fulfilment value and inputs) are based on those in IFRS 13 and were developed for use in that standard. They would need to be changed to work with other measurement bases.

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

We have not commented on SMC2.

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.

We do not agree. As mentioned in our cover letter, we think the IPSASB first needs to decide whether it is going to make any changes to the measurement bases in the Conceptual Framework, the objectives of those measurement bases and the circumstances in which their use would be appropriate.

Flow charts can be very helpful in project scoping and working through issues, and the flow charts in the CP may have been helpful as the IPSASB developed the CP. However, we have concerns about the potential risks of using the flow charts as a starting point for developing standards-level requirements.

- There is a risk that the flow charts will undermine the role of the Conceptual Framework.
- There is a risk that the flow charts could be inconsistent with the Conceptual Framework (to the extent that they incorporate more recent thinking).
- The flow charts highlight a broader debate on measurement (cost verses current value approaches) that has not been fully explored in the CP.
- Flow charts cannot capture all of the factors that might be relevant to consideration of measurement issues in a particular project. There is a risk that the use of the flow charts in a particular project could hinder debates.
- Although the IPSASB says it would consider the flow charts in conjunction with other matters such as reducing unnecessary differences with IFRS Standards, we are concerned that use of the flow charts could lead to these other factors becoming secondary considerations.
- The flow chart will not necessarily guide decision making. Different Board members might consider the matters identified on the flow chart and still come to different conclusions.

Other Comments

The AASB is currently looking at some issues associated with the application of AASB 13 *Fair Value Measurement* to public sector not-for-profit entities which may be of interest to the IPSASB. The AASB is proposing to develop illustrative examples to help public sector entities determine current replacement cost in accordance with AASB 13. The AASB has also been deliberating on whether the fair value of assets held for their service capacity should be determined differently from those assets held primarily for their ability to generate net cash inflows.