AT A GLANCE
November 2012

IPSASB

Conceptual Framework Exposure Draft Summary
Phase 3 of 4—Measurement of Assets and Liabilities in Financial Statements

This summary provides an overview of the Phase 3 Exposure Draft (ED), *Measurement of Assets and Liabilities in Financial Statements*.

Project objectives:

The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities is establishing and defining the concepts to be applied in developing IPSASs. This ED on Phase 3 proposes concepts for selecting measurement bases for assets and liabilities.

The project and stage:

In September 2008 the IPSASB published the first Consultation Paper (CP) in this project on the objectives, the scope, the qualitative characteristics of financial reporting and the reporting entity. Following consideration of respondents' comments the IPSASB issued an ED in December 2010. Separate CPs on Phase 2: *Elements and Recognition in Financial Statements* and Phase 3: *Measurement of Assets and Liabilities in Financial Statements* were issued at the same time.

The IPSASB considered comments on these CPs and issued EDs on both phases in November 2012. A CP on Phase 4: *Presentation in General Purpose Financial Reports* was issued in January 2012. The IPSASB also issued an ED, *Key Characteristics of the Public Sector with Potential Implications for Financial Reporting*, in April 2011.

Next steps:

The IPSASB seeks feedback to guide it in further developing the guidance on selecting measurement bases for assets and liabilities.

Comment deadline:

The ED is open for public comment until April 30, 2013.

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Why is the IPSASB Undertaking this Project?

The purpose of the IPSASB's Conceptual Framework project is to develop concepts, definitions, and principles that respond to the objectives, environment and circumstances of governments and other public sector entities, and therefore, are appropriate to guide the development of IPSASs and other documents dealing with financial reporting by public sector entities.

Many of the current IPSASs are based on International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB), to the extent that the requirements of those IFRSs are relevant to the public sector.

The IASB has a project to develop an improved Conceptual Framework for profit-oriented entities. This project has been recently reactivated and the IPSASB is closely monitoring it. The IPSASB's Conceptual Framework is not an IFRS convergence project, and the purpose of the IPSASB's project is not to interpret the application of the IASB Framework to the public sector.

The concepts underlying statistical financial reporting models, and the potential for convergence with them, will be considered by the IPSASB in developing its Conceptual Framework. The IPSASB is committed to minimizing divergence from the statistical financial reporting guidelines where appropriate.

Although all the components of the Conceptual Framework are interconnected, the project is being developed in phases.

To meet the objectives of financial reporting, information is needed that encompasses financial and non-financial information, past and prospective information and reporting on compliance. General Purpose Financial Reports (GPFRs) are more comprehensive than public sector general purpose financial statements (GPFSs). GPFSs are focused on the financial portrayal of past transactions and events, which affect financial position at a point in time and financial performance for a specified period.

This ED focuses on the measurement of assets and liabilities in the GPFSs of public sector entities. The ED considers that it is not possible to select a single measurement basis for GPFSs that will maximize the extent to which information meets the objectives of financial reporting and the QCs. It therefore does not prescribe a single measurement basis or combination of bases. Instead it identifies the factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances.

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What Approach does the ED Propose?

The ED identifies the measurement concepts that will guide the IPSASB in the selection of measurement bases for its standards, and by preparers where there are no requirements in the standards.

The ED evaluates measurement bases against the objectives of financial reporting and assesses the extent to which information on a particular measurement basis meets the QCs.

Objectives of Financial Reporting

The selection of a measurement basis is particularly important to meeting the information needs of users for accountability and decision-making purposes if it enables assessments of:

(a) Financial capacity—the capacity of the entity to continue to fund its activities and meet its operational objectives in the future;

(b) Operational capacity—the physical and other resources available to support the provision of services in future periods; and

(c) The cost of services provided in the period.

The Qualitative Characteristics (QCs)

The QCs of information included in GPFRs of public sector entities are relevance, faithful representation, understandability, timeliness, comparability, and verifiability.

Materiality, cost-benefit, and achieving an appropriate balance between the QCs are pervasive constraints on information included in GPFRs.

Financial and non-financial information is *relevant* if it is capable of making a difference in achieving the objectives of financial reporting.

To be useful in financial reporting, information must be a *faithful representation* of the economic and other phenomena that it purports to represent. Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error.

Understandability is the quality of information that enables users to comprehend its meaning. GPFRs of public sector entities should present information in a manner that responds to the needs and knowledge base of users, and to the nature of the information presented.

Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena.

Verifiability is the quality of information that helps assure users that information in GPFRs faithfully represents the phenomena that it purports to represent.

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What General Features do Measurement Bases Have?

Measurement bases may be compared by their general features.

Measurement bases may:

- Be historical or current;
- Adopt an entry or exit perspective; and
- Be an entity specific or non-entity specific value.

Historical or Current Cost

The historical cost basis reflects the amount incurred on acquisition of an asset, including transaction costs. Following initial recognition, the measurement of an asset is not changed to reflect changes in prices. Subsequently depreciation is allocated as an expense to reporting periods for certain assets, as the service potential and economic benefits embodied by such assets are consumed over their useful lives. Impairments may also be recognized.

For a liability, the historical cost measurement basis reflects the amount received in the transaction under which the obligation is assumed.

In contrast, a current measurement basis reflects the economic and financial environment prevailing at the reporting date.

Entry or Exit Perspective

An entry value for an asset reflects the consideration payable on its acquisition. An exit value reflects the amount that will be derived from an asset from its sale and/or its use.

Generally, entry values are more relevant to the assessments of costs of services and operational capacity and exit values are more relevant to assessments of financial capacity.

An entry value for a liability relates to the transaction under which an obligation is received or the amount that an entity would accept to assume a liability. An exit value reflects the fulfillment of an obligation or the amount required to release an entity from an obligation.

Entity or Non-Entity Specific

The term “entity specific” is used to refer to measurement bases that reflect the economic position of the entity at the reporting date rather than the position on a market. A “non-entity specific” value reflects a market-based price for an asset or liability.

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What are the Current Value Measurement Bases for Assets?

The ED evaluates four current value measurement bases.

Market Value

Market Value is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction at the reporting date.

Value in Use

Value in use is the present value at the reporting date to the entity of the asset's remaining service potential or economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life.

Replacement Cost

Replacement cost is the most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.

Net Selling Price

Net selling price is the amount that the entity can obtain from sale of the asset at the reporting date, after deducting the costs of sale.

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What are the Attributes of the Measurement Bases for Assets?

The measurement bases discussed in the ED and their attributes can be summarized as shown.

Historical

Historical cost	Entry	Observable at date of acquisition	Entity specific

Current Value

Market value in open, active and orderly market	Entry and Exit are the same	Observable	Non-entity specific
Market value in inactive market	Exit	Dependent on valuation technique	Non-entity specific
Replacement cost	Entry	Observable	Entity specific
Net selling price	Exit	Observable	Entity specific
Value in use	Exit	Unobservable	Entity specific

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Measurement Models

The ED considers two measurement models that may be used in two scenarios:

- **Fair value model**—the ED does not propose fair value as a measurement basis, because market value and fair value are very similar. This model is used to estimate a market value where it has been decided that market value is an appropriate measurement basis, but an open, active and orderly market does not exist.
- **Deprival value model**—the deprival value model can be used for selecting a current measurement basis for operational assets.

Fair Value Model

The objective of the fair value model is to estimate the price at which a transaction to sell the asset would take place in an open, active and orderly market at the measurement date under current market conditions.

This model explicitly produces an exit value: it estimates the price that would be received on sale of an asset. The relevant price is that prevailing in a transaction with another market participant. The fair value model relies on observable market evidence where such evidence is available. The model may, however, also rely on unobservable inputs where observable market evidence is unavailable.

Deprival Value Model

The objective of the deprival value model is to reflect the loss the entity would sustain if it were deprived of the asset (that is, its deprival value). This may also be stated as the amount that the entity would rationally pay to acquire the asset, if it did not already control it.

The model facilitates the selection or confirmation (of the use of) a current measurement basis and can involve consideration of up to three measurement bases—replacement cost, net selling price and value in use.

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What are the Measurement Bases for Liabilities?

The ED reviews five measurement bases for liabilities using the same principles as for assets, but adjusting terminology.

Historical Cost

Historical cost states liabilities at the value of the amount received in the transaction under which the obligation is assumed.

Cost of Release

Cost of release is similar to “net selling price” in the context of assets. Cost of release refers to the amount that relates to an immediate exit from the obligation. Cost of release is the amount that either (a) the creditor will accept in settlement of its claim, or (b) a third party would charge to accept the transfer of the liability from the obligor. Where there is more than one way of securing release from the liability, the cost of release is that of the lowest amount.

Cost of Fulfillment

Cost of fulfillment is the current value of fulfilling the obligations represented by the liability. Where the obligation is financial, fulfillment will be making the required payments; where the obligation is to provide goods or services, fulfillment consists of providing those goods or services.

Market Value

Market value may be appropriate where liabilities are traded in open, active and orderly markets, such as on organized exchanges.

Assumption Price

Assumption price is similar to “replacement cost” in the context of assets. Just as replacement cost represents the amount that an entity would rationally pay to acquire an asset, so assumption price is the amount which the entity would rationally be willing to accept in exchange for assuming an existing liability. Exchange transactions carried out on arms-length terms will provide evidence of assumption price.

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Next Steps

The deadline for comments is April 30, 2013. During the comment period, the IPSASB members are available to discuss the proposals with a wide range of parties.

How Can I Comment on the Proposals?

The ED includes Specific Matters for Comment (SMC) on which the IPSASB is seeking views.

Respondents may choose to answer all SMCs or just a selected few. The IPSASB welcomes comments on any other matters respondents think we should consider in forming our views.

Comment letters will be posted on the IPSASB website.

The IPSASB will carefully consider all feedback and, as usual, discuss responses to the proposals at its public meetings after the comment period has ended.

The IPSASB plans to issue the final chapter on measurement of assets and liabilities in financial statements, reflecting its actions to address respondents' comments, in 2014.

Stay Informed

The IPSASB will announce on its website the dates and location of meetings to discuss feedback on the ED.

To stay up to date about the project, please visit: https://www.ifac.org/public-sector/projects/public-sector-conceptual-framework