

**Meeting:** International Public Sector Accounting Standards Board

**Meeting Location:** Washington D.C., USA

**Meeting Date:** March 12–15, 2019

## Agenda Item **6**

**For:**

Approval

Discussion

Information

### Public Sector Measurement

<b>Project summary</b>	Project will revise IPSAS requirements for measurement and measurement-related disclosure, provide guidance on measurement and address the treatment of transaction costs and borrowing costs.	
<b>Meeting objectives</b>	<b>Topic</b>	<b>Agenda Item</b>
<b>Project management</b>	<a href="#">Instructions up to March 2019 Meeting</a>	<a href="#">6.1.1</a>
	<a href="#">Decisions up to March 2019 Meeting</a>	<a href="#">6.1.2</a>
	<a href="#">Project Roadmap</a>	<a href="#">6.1.3</a>
<b>Decisions required at this meeting</b>	<a href="#">Consultation Paper, <i>Public Sector Measurement</i>, Changes Since December</a>	<a href="#">6.2.1</a>
	<a href="#">Transaction Costs</a>	<a href="#">6.2.2</a>
	<a href="#">Applicability of IFRS 5 in the Public Sector</a>	<a href="#">6.2.3</a>
	<a href="#">Market Value Compared to Fair Value Measurement</a>	<a href="#">6.2.4</a>
	<a href="#">Measurement Flowcharts – Consultation Paper Chapter 4: Public Sector Measurement</a>	<a href="#">6.2.5</a>
	<a href="#">Approval of the Consultation Paper, <i>Public Sector Measurement</i>, and Illustrative Exposure Draft</a>	<a href="#">6.2.6</a>
<b>Other supporting items</b>	<a href="#">Appendix A – Marked Up Consultation Paper, Including Illustrative Exposure Draft</a>	<a href="#">6.3.1</a>
	<a href="#">Appendix B – Marked Up IFRS 5, Non-Current Assets Held for Sale and Discontinued Operations</a>	<a href="#">6.3.2</a>
	<a href="#">Appendix C – Task Force Issues Papers</a>	<a href="#">6.3.3</a>

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## INSTRUCTIONS UP TO MARCH 2019 MEETING

Meeting	Instruction	Actioned
December 2018	<ol style="list-style-type: none"> <li>1. The IPSASB instructed staff to make the following changes to the ED;                             <ol style="list-style-type: none"> <li>a) Remove unnecessary paragraphs (limit sections defining each measurement basis to 1 paragraph);</li> <li>b) Include only measurement bases with a corresponding appendix;</li> <li>c) Relocate reference on “unused” measurement bases to the CP (for example, Assumption Price);</li> <li>d) Develop SMC asking constituents whether they require further guidance on any measurement basis;</li> <li>e) Complete the Replacement Cost Appendix and elevate it to a principled level; and</li> <li>f) Reference the source of the guidance.</li> </ol> </li> <li>2. The IPSASB instructed staff to make the following changes to the CP;                             <ol style="list-style-type: none"> <li>a) Revisit the transaction costs chapter to incorporate the IPSASB discussion; and</li> <li>b) Be consistent in the diagrams illustrating the relationship between the CP/ED.</li> </ol> </li> <li>3. The IPSASB instructed staff to incorporate IPSASB discussion into the “least costly manner” to the Cost of Fulfillment Principles;</li> <li>4. The IPSASB instructed staff to incorporate guidance on Assets Held for Sale or Disposal (either by asking a question in the CP or developing guidance).</li> </ol>	<ol style="list-style-type: none"> <li>a) See <a href="#">Exposure Draft (paragraphs 7-23)</a></li> <li>b) See <a href="#">Exposure Draft</a></li> <li>c) See Chapter 2 (<a href="#">paragraph 2.17</a>)</li> <li>d) See <a href="#">SMC Chapter 4.1</a></li> <li>e) See <a href="#">ED Appendix D</a></li> <li>f) See <a href="#">ED</a> (material referenced throughout)</li> <li>a) See CP Chapter 3 (<a href="#">paragraph 3.27 – 3.51</a>)</li> <li>b) See CP <a href="#">Project Overview</a></li> <li>3. See ED (<a href="#">paragraph A7</a>)</li> <li>4. See <a href="#">Agenda Item 6.2.3</a></li> </ol>
September 2018	<ol style="list-style-type: none"> <li>1. Apply the Project Overview approach to the CP and ED to submit complete documents to the December meeting.</li> <li>2. Include an illustration in the ED of the approach of including generic measurement-related disclosures for measurement bases.</li> <li>3. Review the fair value text for specific text that belongs in IPSAS 41 (financial instruments) or another individual IPSAS. Coordinate with Financial Instruments Task Force and staff.</li> </ol>	<ol style="list-style-type: none"> <li>1. Done</li> <li>2. Disclosures in appendices</li> <li>3. Done</li> </ol>

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	<ol style="list-style-type: none"> <li>4. Revise ED's objective, scope and definitions (including adding new definitions).</li> <li>5. Develop explanatory text for measurement bases.</li> <li>6. Identify/develop generic guidance for inclusion in the ED's appendices.</li> <li>7. Make recommendation on an appendix for measurement of assets held for sale or disposal.</li> <li>8. Assess whether best estimate in IPSAS 19, <i>Provisions, etc.</i> is same as "cost of fulfillment."</li> <li>9. Develop explanatory section for CP-ED, with visuals and statement that this is not an IFRS-alignment project.</li> <li>10. Develop the flow charts with examples to illustrate their application to particular topics.</li> </ol>	<ol style="list-style-type: none"> <li>4. Not done</li> <li>5. Done</li> <li>6. Done</li> <li>7. Done</li> <li>8. Done</li> <li>9. Done</li> <li>10. Done</li> </ol>
June 2018	<ol style="list-style-type: none"> <li>1. Develop the flow chart for subsequent measurement of assets so that it also addresses financial instruments.</li> <li>2. Develop definitions or explanations of key terms used in the flowchart.</li> <li>3. Provide recommendations on what amendments should be made to the text of IFRS 13, Fair Value Measurement, for inclusion in ED, Measurement.</li> <li>4. Revise the table of equivalence.</li> <li>5. Develop a flow chart and ED text for the subsequent measurement of liabilities, and consider the contractual/non-contractual distinction during development.</li> <li>6. Develop an At-a-Glance summary of the project.</li> </ol>	<ol style="list-style-type: none"> <li>1. Done</li> <li>2. Done</li> <li>3. Done</li> <li>4. In progress</li> <li>5. Done/ in progress</li> <li>6. Topic 1's project overview</li> </ol>
March 2018	<ol style="list-style-type: none"> <li>1. Present combined CP and ED document using mark-up to identify text changes since March.</li> <li>2. For ED, (a) locate definitions after scope paragraph(s); (b) include all IFRS 13 definitions and other material for fair value, (c) add a Basis for Conclusions, (d) remove ED footnotes, (e) review IPSAS 17 for coverage to include, and (f) retain two impairment IPSASs.</li> <li>3. For the ED's Basis for Conclusions (a) include Chapter 7's discussion of fair value, (b) show relationship between fair value and market value, and (c) reflect IPSASB's decision that fair value may apply.</li> <li>4. For CP, (a) consider whether outline approved in December should be revised, (b) revise arguments in</li> </ol>	<ol style="list-style-type: none"> <li>1. Done</li> <li>2. Done</li> <li>3. Done</li> <li>4. Done</li> </ol>

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	<p>Chapter 3 and circulate for intermeeting IPSASB review.</p> <p>5. Develop a flow chart for measurement of assets and focus on asset measurement for June.</p> <p>6. Transaction costs and borrowing costs: (a) consider how IVS define transaction costs, (b) develop two definitions for transaction costs related to entry/exit values, and (c) provide recommendation on whether transaction costs should be discussed in the CP or in the ED's Basis for Conclusions.</p> <p>7. Develop an equivalence table.</p> <p>8. Consider qualitative characteristics and constraints as they apply to measurement.</p>	<p>5. Done</p> <p>6. In progress</p> <p>7. Done</p> <p>8. In progress</p>
December 2017	<p>1. Consider definitions used in International Valuation Standards (IVS) and Government Finance Statistics (GFS).</p> <p>2. Monitor discount rate developments and bring paper to IPSASB's September 2018 meeting.</p> <p>3. Review IPSASs against the Conceptual Framework with no presumption that current measurement requirements should continue.</p> <p>4. Develop ED sections for the March 2018 IPSASB meeting.</p>	<p>1. Done</p> <p>2. In progress</p> <p>3. Done</p> <p>4. Done</p>
September 2017	<p>1. Develop a hybrid IPSAS that applies the Conceptual Framework to public sector specific (PSS) measurement issues and has a section on application of IFRS 13's approach to fair value (Option B).</p> <p>2. Develop an outline of the CP.</p> <p>3. Develop a description of public sector specific (PSS) measurement issues.</p> <p>4. Develop proposals for when either a PSS measurement approach is needed or where an IFRS 13 fair value measurement approach could apply.</p> <p>5. Consider the boundary between IPSAS, <i>Measurement</i>, and individual IPSASs.</p> <p>6. Test responses to CP, <i>Heritage</i>, against the PS Measurement approach.</p>	<p>1. In progress</p> <p>2. Done</p> <p>3. Done</p> <p>4. Done</p> <p>5. Done. See ED outline</p> <p>6. Will apply ED principles</p>
June 2017	<p>1. Consider convergence with IFRS, particularly scope to incorporate an IFRS 13, <i>Fair Value Measurement</i>, approach into IPSAS.</p> <p>2. Apply the Conceptual Framework's measurement objective to the treatment of transaction costs.</p> <p>3. For September 2017 IPSASB meeting:</p> <p style="padding-left: 20px;">c) Bring back the transaction costs and borrowing costs issues as part of a more general discussion of asset valuation for the IPSASB's consideration;</p>	<p>1. Done</p> <p>2. Done</p> <p>3 (a) Done</p>

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	<ul style="list-style-type: none"> <li>d) Provide an education session on IFRS 13 and its post-implementation review; and</li> <li>e) Discuss ways to address fair value in IPSAS, in the context of the Conceptual Framework's approach to current value measurement and IFRS 13's approach.</li> </ul>	<p>3 (b) Done</p> <p>3 (c) Done</p>
March 2017	<ol style="list-style-type: none"> <li>1. Revise project brief and create project page.</li> <li>2. Develop a questionnaire for IPSASB/Technical Adviser/Observers' input on the project's scope.</li> <li>3. Identify project work streams.</li> <li>4. Provide education session on the IASB's post implementation review of IFRS 13 in September.</li> <li>5. Log information on how other IPSASB projects relate to the Public Sector Measurement project.</li> </ol>	<p>1. Done</p> <p>2. Done</p> <p>3. Done</p> <p>4 Done</p> <p>5 Done</p>
September 2015 to December 2016	Project awaits start. First discussion in March 2017.	Done
June 2015	Revise project brief for IPSASB revisions.	Done

## DECISIONS UP TO MARCH 2019 MEETING

Date of Decision	Decision
December 2018	<ol style="list-style-type: none"> <li>1. The IPSASB agreed the following for the Cost of Fulfillment Principles:               <ol style="list-style-type: none"> <li>a) Costs should only include future outflows the entity expects to satisfy the obligation;</li> <li>b) The obligation will be fulfilled in the normal course of operations;</li> <li>c) Cost of fulfillment is a liability measurement basis; and</li> <li>d) Cost of fulfillment is an entity specific measure.</li> <li>e) Applying the Project Overview approach, ED, <i>Measurement</i>, will define each measurement basis and provide explanatory material in its core text and application guidance on how to derive the measurement bases in its appendices, while individual IPSASs will continue to address which measurement basis should be used.</li> </ol> </li> <li>2. The IPSASB agreed the discount rate guidance should be maintained at a principled level and that the cost of fulfillment guidance will not distinguish between market and incremental borrowing rate.</li> </ol>
September 2018	<ol style="list-style-type: none"> <li>1. Applying the Project Overview approach, ED, <i>Measurement</i>, will define each measurement basis and provide explanatory material in its core text and application guidance on how to derive the measurement bases in its appendices, while individual IPSASs will continue to address which measurement basis should be used.</li> <li>2. Measurement-related disclosures could be located as follows; neutral (generic) in ED, <i>Measurement</i>, and specific in the relevant IPSAS.</li> <li>3. The IPSASB agreed to adopt the majority of fair value text from IFRS 13 in application guidance or in another IPSAS(s), reflecting the Financial Instruments Task Force and staff recommendation.</li> <li>4. Develop ED, <i>Measurement</i>, further, as per point (1) above.</li> <li>5. ED, <i>Measurement</i>, appendices for December will have generic application guidance for historical cost, replacement cost, fair value, and cost of fulfillment.</li> <li>6. Guidance specific to a particular topic remains in the individual IPSASs.</li> <li>7. CP, <i>Public Sector Measurement</i>, to be developed further, consistent with the Project Overview approach in point (1) above.</li> <li>8. There should be sufficient coverage of measurement issues raised by assets held for service potential/capacity, within the context of the Conceptual Framework measurement objective.</li> </ol>
June 2018	<ol style="list-style-type: none"> <li>1. The table of equivalence will not be authoritative.</li> <li>2. The measurement basis for subsequent measurement of liabilities can be different from that for initial measurement.</li> </ol>

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March 2018	<ol style="list-style-type: none"> <li>1. Agreed ED paragraphs for objective and scope.</li> <li>2. ED, <i>Measurement</i> will cover measurement for all IPSASs.</li> <li>3. ED, <i>Measurement</i>, will include IFRS 13 text, not refer to IFRS 13.</li> <li>4. ED, <i>Measurement</i>, will have a Basis for Conclusions.</li> <li>5. Agreed a Preliminary View to expense all borrowing costs.</li> </ol>
December 2017	<ol style="list-style-type: none"> <li>1. Apply ED and CP outlines (December 2017 meeting) for their development.</li> <li>2. For project's timeline, Route 1 used for planning purposes.</li> </ol>
September 2017	<ol style="list-style-type: none"> <li>1. The CP will wrap around an ED.</li> <li>2. IPSAS, <i>Measurement</i>, should be a hybrid IPSAS that applies the Conceptual Framework to public sector specific measurement issues and has a section on application of IFRS 13 fair value.</li> <li>3. Treatment of borrowing costs issue will be included in the CP.</li> <li>4. Project will address measurement of heritage and infrastructure assets through Application Guidance in IPSAS, <i>Measurement</i>.</li> </ol>
June 2017	Work on measurement guidance and disclosures will occur after work on measurement bases.
March 2017	Approved revisions to the project brief
September 2015 to December 2016	No decisions as project awaits start. First discussion will be in March 2017.
June 2015	Approved the "Public Sector Measurement" project brief.

### PROJECT ROADMAP<sup>1</sup>

Meeting	Completed Discussions/ Planned Discussions:
<b>Next meeting<sup>2</sup></b>	
June 2019	1. Document out for comment
<b>This meeting</b>	
March 2019	1. Approve Exposure Draft and Consultation Paper (CP) for issuance. 2. Decision on exposure period.
<b>Past meeting</b>	
December 2018	1. Review the ED as a whole—(1) objective, scope, definitions, explanatory text for measurement bases; (2) measurement-related disclosures; (3) application guidance for historical cost, replacement cost, fair value, and cost of fulfillment; and, (4) the basis for conclusions, including basis for treatment of fair value and measurement-related disclosures.  2. Review the CP as a whole: (1) visual explanation for the CP/ED package; (2) any revisions to Chapters 1-6, since September; (3) transaction costs; and (4) flow charts.  3. Consider related issues: For the ED, (1) Report back from Financial Instruments Task Force (application guidance), (3) measurement-related disclosures, and (4) accounting for sale/disposal of assets. For the CP, treatment of transaction costs (topic (5)).
September 2018	1. Approved Project Overview approach, whereby IPSAS, Measurement will cover the meaning of measurement bases and application guidance for them (i.e. address what and how), while other IPSASs identify the applicable measurement base(s) (i.e. address which).  2. Provided comment on draft application guidance for the ED; approved recommendations on fair value text; and, reviewed Chapters 1-6 of the CP. Noted draft ED sections for objective, scope, definitions, and illustrative coverage of explanatory text, and application guidance.

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<sup>1</sup> The project's approach changed during May-September 2018. This road map has been revised to reflect the changes.

<sup>2</sup> Meetings after the exposure period for ED/CP, *Measurement*, are shown on the following page.

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Meeting	Planned Discussions (After Exposure of ED/CP)
December 2019	1. Review of responses to ED/CP.
March 2020	1. Review IPSAS, <i>Measurement</i> (draft). 2. Discuss proposed consequential amendments.
June 2020	1. Approve ED 2, <i>Amendments to IPSASs Measurement Requirements</i> , for issuance. 2. Approve IPSAS, <i>Measurement</i> (Draft), which will accompany ED 2.
March 2021	1. Review responses to ED 2, <i>Amendments to IPSASs for Measurement</i>
June 2021	1. Review the draft pronouncement on consequential amendments; and 2. Discuss any issues related to the draft pronouncement.
September 2021	1. Approve consequential amendment for issuance/application to IPSASs.

## Consultation Paper, *Public Sector Measurement*, Changes Since December

### Purpose

- To provide the Board with a summary of the changes made to the Consultation Paper / Illustrative Exposure Draft since the December 2018 IPSASB meeting.

### Background

- At its December 2018 meeting, the Board performed a detailed review of the Consultation Paper/Illustrative Exposure Draft. The Board discussed a number of issues and proposed a number of changes for Staff to action for the March 2019 meeting.
- In addressing the IPSASB comments, staff made significant changes to the document reviewed by the IPSASB in December 2018.

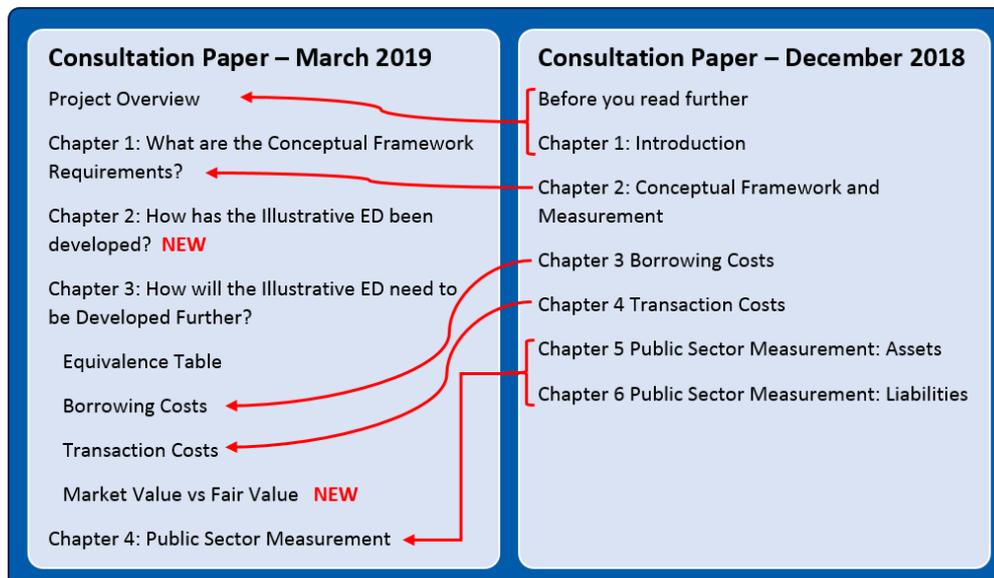
### Detail

#### *Task Force Involvement*

- Staff reviewed the action items identified at the end of the December 2018 IPSASB meeting. Staff identified issues requiring a high level of professional judgement and leaned heavily on the Task Force for their expertise. The Task Force was involved in, and provided recommendations on, the following issues:
  - Transaction costs (see Agenda Items [6.2.2](#));
  - Assets held for sale (see Agenda Items [6.2.3](#)); and
  - Relationship between fair value and market value (see Agenda Items [6.2.4](#)).
- The remaining changes made to the document, while voluminous, were either editorial in nature or direct and clear action items from the IPSASB. In both cases, as limited judgement was required, involvement of the Task Force was unnecessary.

#### *Changes to the Document Since December 2018*

- In addressing items raised by the IPSASB, staff repurposed a significant amount of material existing in the December 2018 Consultation Paper as follows:



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## Project Overview

Material in the section	Source of material
This section outlines what the outputs of the project will be and the process the project will follow in developing those outputs.	Guidance is largely repurposed from “Before You Read” section and “Chapter 1: Introduction”.

## Chapter 1: What are the Conceptual Framework Requirements

Material in the section	Source of material
This section outlines the requirements in the conceptual framework.	Guidance is largely repurposed from “Chapter 1: Conceptual Framework and Measurement”.

## Chapter 2: How has the Illustrative ED been developed?

Material in the section	Source of material
This section outlines where the material in the Illustrative Exposure Draft came from.	<p>New to the March 2019 draft.</p> <p>Material on “Measurement Bases Omitted from ED, <i>Measurement</i>” was sourced from measurement bases in the December ED not included in appendices (Assumptions Price, Cost of Release, etc.). These were removed from the ED.</p>

## Chapter 3: How will the Illustrative ED need to be Developed Further?

Material in the section	Source of material
<p>This section outlines specific areas on which the IPSASB wants constituent feedback in improving the ED. These areas include:</p> <ul style="list-style-type: none"> <li>- Using IVS and GFS;</li> <li>- Borrowing costs;</li> <li>- Transaction costs; and</li> <li>- Market value compared to fair value.</li> </ul>	<p>Guidance is largely repurposed from “Chapter 3: Borrowing Costs” and “Chapter 4: Transaction Costs”. See below:</p> <ul style="list-style-type: none"> <li>- Based on June Equivalence Table;</li> <li>- Based on Chapter 3;</li> <li>- Based on Chapter 4**, and</li> <li>- New material**.</li> </ul> <p>** Task Force was involved in the development of both sections due to the high level of judgment required. See paragraph 4 above for further details.</p>

## Chapter 4: Public Sector Measurement

Material in the section	Source of material
This section outlines the proposed approach to developing consequential amendments for	Guidance combines “Chapter 5: Public Sector Measurement: Assets” and “Chapter

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other IPSAS. This section includes the asset and liabilities flow charts.	6: Public Sector Measurement: Liabilities” to better focus on the objective of the chapter.
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7. In addressing items raised by the IPSASB, staff made the following significant changes to the December 2018 Illustrative Exposure Draft:

(a) Removed omitted measurement bases

Explanatory text on measurement bases for which no appendix was developed was removed from the Illustrative Exposure Draft. Some of this material was moved to Chapter 2 of the Consultation Paper.

(b) Added a section on Transaction Costs

Based on the views outlined in the Consultation Paper, a section on transaction costs was added to the core Illustrative Exposure Draft, with minor sections added to each appendix.

(c) Re-organized Appendix D: Replacement Cost

The IPSASB instructed staff to complete the Replacement Cost Appendix and elevate it to a principles level. The December material was complete, but now it is ordered consistently with the other appendices.

### Decision required

8. No decision required. For information purposes only.

### Transaction Costs

#### Question

1. Whether the Board agrees with the recommendation on how to account for transaction costs in the Consultation Paper/Illustrative ED.

#### Detail

2. At the December meeting, the IPSASB noted there was inconsistency in accounting for transaction costs across the four measurement bases addressed in the appendices. The IPSASB directed Staff to develop a principle to address this issue.
3. Staff determined this issue required considerable judgement and included the Task Force in developing a recommendation for consideration by the IPSASB.

#### Task Force Analysis

4. The issue the Task Force addressed is whether to include or exclude transaction costs in measuring a particular transaction. The Task Force debated this issue in three parts:

- (a) How should transaction costs be defined in the public sector;

This discussion considered whether a universal definition of transaction costs applied to the public sector (i.e., are transaction costs the same for PP&E transactions as for financial instrument transactions).

The Task Force concluded that the wide interpretation of what qualifies as a transaction cost is a result of insufficient guidance. In reviewing the definition of transaction costs in GFS and IVS, the Task Force concluded the existing IPSAS definition of transaction costs could be clarified by incorporating elements of the GFS and IVS into interpretive guidance explaining the definition of transaction costs in the Illustrative Exposure Draft (see paragraph [3.35](#) of the Consultation Paper and paragraphs [24-28](#) of the Illustrative Exposure Draft).

- (b) Where should the guidance be located; and

Based on the conclusion that a generic definition of transaction costs can be established in IPSAS (see paragraph 4(a)), the Task Force concluded guidance should be located in the Illustrative Exposure Draft. The Task Force believed disaggregating transaction cost guidance into each IPSAS is only appropriate if transaction costs are different depending on the transaction.

- (c) How should transaction costs be accounted for?

The Task Force considered three options:

- Whether a universal rule should be developed, for example, expense all transaction costs;
- Whether they should be accounted for based on the transaction; or
- Whether they should be accounted for based on the measurement basis.

The Task Force concluded a universal rule was inappropriate as it did not reflect the different measurement objectives of each measurement basis, and accounting for transaction costs based on the specific transaction is inconsistent with the concept of a

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measurement basis being applied consistently across different transactions (for example, the principles of fair value measurement are the same whether applied to PP&E or financial instruments).

### *Accounting for Transaction Costs According to the Measurement Basis*

The Task Force concluded that the most important consideration in determining whether transaction costs should be included or excluded from measurement is what the measurement basis is trying to present to the financial statement user – an entry price or an exit price. This is consistent with GFS and IVS and guidance established in IPSAS - transaction costs are excluded from exit based measurements and included in entry based measurements.

In testing the “measurement objective” consideration, the Task Force applied it to each of the four measurement bases defined in the Illustrative Exposure Draft. When applied to the cost of fulfillment measurement basis, the Task Force encountered an unexpected result.

This unexpected result occurred because the Task Force had not previously considered that transaction costs can arise both:

- When an asset is acquired or a liability is incurred, and
- When an asset is sold or disposed of or a liability is settled or transferred.

The “measurement objective” consideration was developed, unknowingly, with a focus on entry-based transaction costs. For example, the “measurement objective” consideration requires all transaction costs to be excluded from exit-based measurements. Since the objective of cost of fulfillment – an exit price – is to present how much the entity will incur to settle the liability, excluding transaction costs to enter the liability is appropriate. However, excluding transaction costs to exit the liability does not reflect the economics of the transaction to the financial statement user.

To address this issue, a second consideration, the timing of the transaction costs, was added. This addresses both entry and exit based costs and is applicable for, and even augments, guidance on the other measurement bases – historical cost, fair value and replacement cost.

Measurement Basis	Measurement Objective	Accounting for Transaction Costs	
		Entry Costs	Exit Costs
Cost of Fulfillment ( <a href="#">Appendix A</a> of Exposure Draft)	Exit price	Exclude	Include
Fair Value ( <a href="#">Appendix B</a> of Exposure Draft)	Exit price	Exclude	
Historical Cost ( <a href="#">Appendix C</a> of Exposure Draft)	Entry price	Include	Exclude
Replacement Cost ( <a href="#">Appendix D</a> of Exposure Draft)	Entry price	Include	Exclude

**Task Force Recommendation**

5. The Task Force recommends:
  - (a) The existing IPSAS transaction costs definition be supplemented with interpretive guidance based on GFS and IVS;
  - (b) The guidance be included in the Illustrative Exposure Draft (as opposed to disaggregated through IPSAS); and
  - (c) Accounting for transaction costs should include two considerations:
    - (i) The measurement objective (exit price or entry price); and
    - (ii) The timing of the transaction costs (incurred on entry or exit).

**Decision required**

6. Does the IPSASB agree with the Task Force's recommendation?

### Applicability of IFRS 5 in the Public Sector

#### Question

1. Whether the Board agrees with the recommendation measurement of assets held for sale should be addressed separately from the IPSASB measurement project.

#### Detail

2. In December, the IPSASB considered the relevance of IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* (IFRS 5) for the public sector. The Board instructed the Staff to incorporate guidance on Assets Held for Sale or Disposal (either by asking a question in the CP or developing guidance).

#### Task Force Analysis

##### *Applicability of IFRS 5 to Public Sector*

3. IFRS 5 provides guidance on the following aspects of assets held for sale:
  - (a) *Classification* of non-current assets or disposal groups as held for sale or for distribution to owners;
  - (b) *Measurement* of non-current assets or disposal groups classified as held for sale; and
  - (c) Related presentation and disclosure requirements.
4. The guidance on measurement addresses what measurement basis to use for these assets – fair value less cost to sell or carrying amount – rather than how to calculate a measurement basis.
5. While what measurement basis to use for these assets is important in the public sector, because the guidance does not address how to calculate a measurement basis, it falls outside the Illustrative ED's scope.

##### *Applicability of fair value less cost to sell measurement basis to Public Sector assets held for sale*

6. IFRS 5 requires an asset held for sale or disposal to be measured at the lower of carrying amount and fair value less costs to sell.
7. The Task Force took the view that a public sector entity will not normally hold assets for sale or disposal but rather assets might become available for sale or disposal for one or more of a number of reasons. For example, an aging demographic may result in an elementary school no longer being needed in a particular area. In practice, therefore, an asset that had been held for its operational capacity will now contribute to the entity's financial capacity.
8. The Task Force therefore considered whether fair value is the most appropriate measurement basis for assets held for sale in the public sector given that such assets may often be specialized operational assets or heritage assets which do not have an active market. The Task Force tentatively concluded that this may suggest that net selling price is a more appropriate measurement basis to apply, given that it accounts for any constraints on sale, is entity specific and better reflects the expected amount that would be received by the entity on sale of the asset, but agreed that further analysis is required.

**Task Force Recommendation**

9. The Task Force recommends:

- (a) Guidance in IFRS 5 falls outside of the scope of the measurement project because it addresses the what and not the how;
- (b) Some of the guidance in IFRS 5 is relevant to the public sector and should be incorporated into IPSAS (not necessarily an alignment project); and

IFRS 5 has been marked up for modifications related to public sector financial reporting needs and the special characteristics of the public sector (see [Appendix B](#)). This is provided only for discussion purposes as the Task Force believes additional analysis is required to determine whether the measurement bases proposed in IFRS 5, specifically fair value less cost to sell, are applicable to similar public sector transactions.

- (c) Further analysis is required after March 2019.

**Decision required**

Does the IPSASB agree with the Task Force's recommendation?

### Market Value Compared to Fair Value Measurement

#### Question

1. Whether the Board agrees with the recommendation that alignment/differentiation of market value measurement and fair value measurement in the public sector should be addressed in Phase II of the Public Sector Measurement project.

#### Detail

2. One objective for this project is to determine whether the fair value measurement basis is relevant and faithfully represents some assets and liabilities held by public sector entities. The Board identified this as an issue because there are a number of references to the fair value basis in IPSAS. However, the Conceptual Framework does not include fair value as a measurement basis.<sup>3</sup>
3. Due to the importance of this issue, the Task Force considered how to further incorporate fair value in IPSAS and better align or differentiate fair value and market value.

#### Task Force Analysis

4. The Task Force noted that distinguishing between Fair Value and Market Value is challenging (see the equivalence table in [Addendum A Consultation Paper](#)).
  - (a) Market value is defined in the conceptual framework as the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.
  - (b) Fair value is defined in the Illustrative ED as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
5. At present, the IFRS 13 definition of fair value is explicitly exit-based, while market value is neutral – either entry or exit. This overlap highlights the need to clarify the differences between fair value and market value.
6. The Task Force believes there are circumstances where a public sector entity requires the ability to measure an entry value or an exit value when valuing an asset or liability at its current value in order to achieve the measurement objective. For example, the purpose for which an entity is holding an asset (for operational purposes or for sale) impacts whether the measurement objective is to present the current value to replace the asset – an entry value – or the current value to sell the asset – an exit value. As such, the Task Force continues to support the concepts developed for market value. However, the Task Force also recognizes the ability to differentiate between market value and fair value is of paramount importance.
7. The Task Force does not see an immediate resolution to this issue. This is partly due to the fact that Market Value is defined in the Conceptual Framework and Fair Value is not. The Task Force is of the view in order to fully address the overlap in these measurement bases, the issue will

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<sup>3</sup> While the Conceptual Framework does not identify Fair Value as a measurement basis, paragraph BC7.28 of the conceptual framework notes the IPSASB may carry out further work at standards level to explain how the measurement bases in this chapter align with fair value, as implemented in IFRS.

## **Agenda Item 6.2.4**

need to be addressed in conjunction with the Limited-Scope Review of the Conceptual Framework.

### **Task Force Recommendation**

8. The Task Force recommends addressing the overlap of Market Value and Fair Value as part of Phase II of the project.

### **Decision required**

Does the IPSASB agree with the Task Force's recommendation?

**Measurement Flowcharts – Consultation Paper Chapter 4: Public Sector  
Measurement****Question**

1. Whether the Board agrees Chapter 4 of the Consultation Paper appropriately reflects the IPSASB's views in how the measurement principles in the Conceptual Framework should be interpreted at standards level.

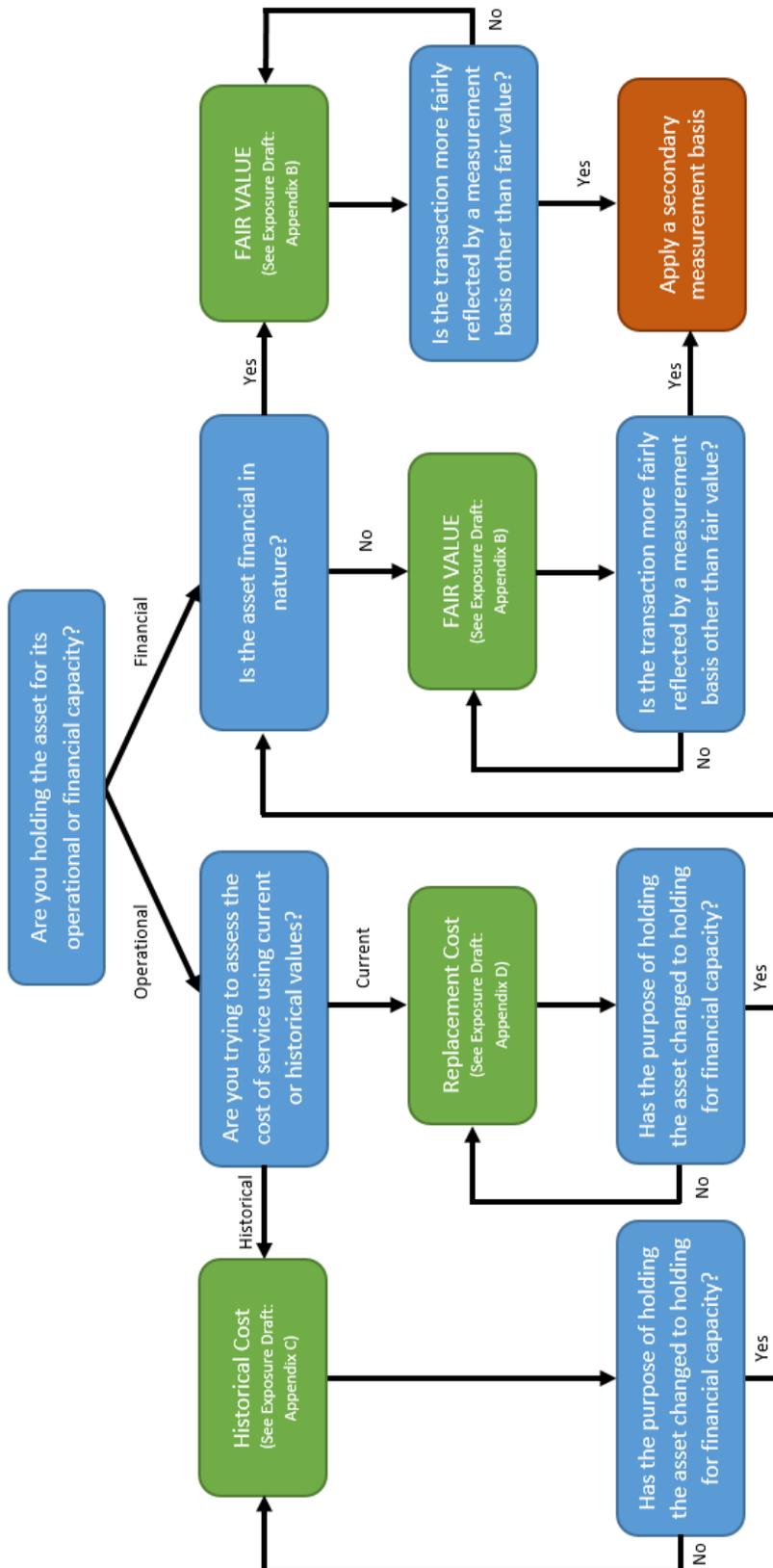
**Detail**

2. Staff has developed two flowcharts, see [Addendum A](#) and [Addendum B](#) to this Agenda Item, based on the measurement principles in Chapter 7 of the Conceptual Framework. The flowcharts were developed to act as a bridge between those principles in the Conceptual Framework and their application throughout IPSAS.
3. The flowcharts address how the measurement principles in the Conceptual Framework should be interpreted at standards level and sets out the methodology the IPSASB will adopt in reviewing existing IPSAS and developing new IPSAS.
4. Staff has stated clearly that the Board does not expect to use these flowcharts in a rigid, inflexible way. Any 'answer' that the flow chart suggests in relation to a measurement basis for a particular type of asset or liability will be tested against the considerations in the conceptual framework.
5. These flowcharts are designed to help the Board consistently apply its measurement principles across IPSAS, while still providing the Board the flexibility to depart when the economic substance of a transaction is better represented by another measurement basis.
6. These flowcharts, along with how the IPSASB will use them and an explanation of key decision points are included in Chapter 4 of the Consultation Paper.

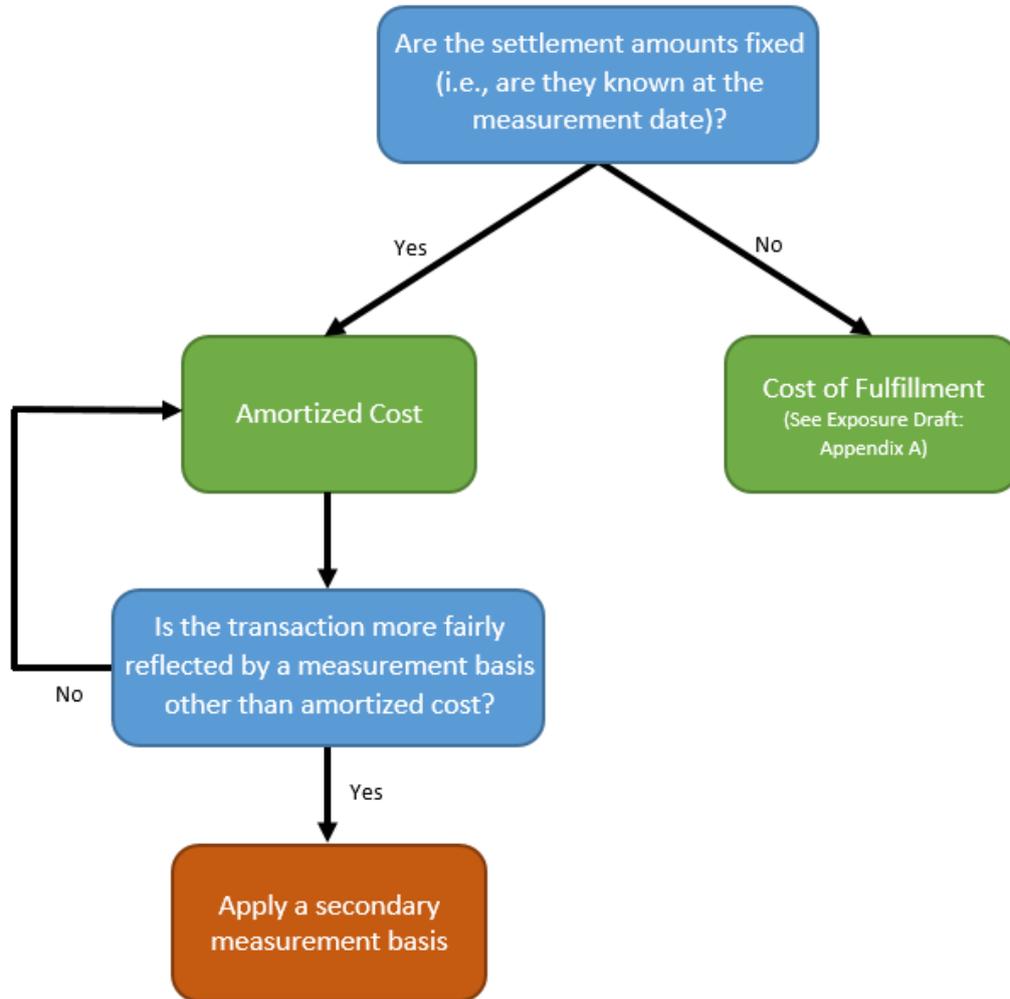
**Decision required**

7. Does the IPSASB agree Chapter 4 of the Consultation Paper appropriately reflects the IPSASB's views in how the measurement principles in the Conceptual Framework should be interpreted at standards level?

**Addendum A – Assets Flow Chart**



## Addendum B – Liabilities Flow Chart



**Approval of the Consultation Paper, *Public Sector Measurement*, and Illustrative Exposure Draft****Purpose**

1. The IPSASB is asked to approve Consultation Paper, *Public Sector Measurement*, including the Illustrative Exposure Draft, and to agree with the proposed exposure period.

**Due Process**

2. The IPSASB completed a review of the Consultation Paper, *Public Sector Measurement*, at its December 2018 meeting. This review included discussion of a number of issues, some of which the Board asked for changes to be made. With the support of the Task Force, Staff actioned those changes (see Agenda Item [6.2.1](#)).
3. The Measurement Task Force held two teleconferences to discuss issues requiring the application of significant professional judgement and provided their recommendations to the IPSASB. The following points highlight key information related to the teleconferences and the process for developing material:
  - (a) The Task Force discussed issues requiring significant professional judgement allowing the IPSASB to focus on recommendations at its March meeting:
    - (i) Transaction costs (see Agenda Item [6.2.2](#));
    - (ii) Assets held for sale (see Agenda Item [6.2.3](#)); and
    - (iii) The relationship between fair value and market value (see Agenda Item [6.2.4](#)).
  - (b) The Task Force provided excellent feedback in advancing the issues and reached consensus on all recommendations.
4. Staff recommends an exposure period ending September 30, 2019. While longer than normal, this allows the IPSASB to take advantage of the September 17<sup>th</sup> Research Forum on Public Sector Measurement at the Parthenope University in Naples allowing more constituents to engage.

**Decision required**

The IPSASB is asked to:

- Confirm it is satisfied there are no additional issues to be discussed by the IPSASB at this time;
- Approve Consultation Paper, *Public Sector Measurement*, including the Illustrative Exposure Draft for comment; and
- Confirm an exposure period ending September 30, 2019.

## Appendix A – Consultation Paper, Including Illustrative Exposure Draft

1. Appendix A includes:
  - (a) [Consultation Paper](#);
  - (b) [Illustrative Exposure Draft](#); and
  - (c) [Illustrative Exposure Draft \(marked up\)](#).
2. No mark-up of the Consultation Paper is provided due to the number of revisions since the version the Board reviewed in December.

**Consultation Paper**  
**April 2019**  
*Comments due: September 30, 2019*

# Public Sector Measurement

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets IPSAS™ and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants® (IFAC®).

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## REQUEST FOR COMMENTS

This Consultation Paper, *Public Sector Measurement*, was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The proposals in this Consultation Paper may be modified in light of comments received before being issued in final form. **Comments are requested by September 30, 2019.**

Respondents are asked to submit their comments electronically through the IPSASB website, using the “[Submit a Comment](#)” link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. This publication may be downloaded from the IPSASB website: [www.ipsasb.org](http://www.ipsasb.org). The approved text is published in the English language.

### Guide for Respondents

The IPSASB welcomes comments on all of the matters discussed in this Consultation Paper, including all Preliminary Views and Specific Matters for Comment. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate and contain a clear rationale.

The Preliminary Views and Specific Matters for Comment in this Consultation Paper are provided below. Paragraph numbers identify the location of the Preliminary View or Specific Matter for Comment in the text.

#### Preliminary View—Chapter 2.1 (following paragraph 25)

Guidance on historical cost is derived from existing text in IPSAS. The IPSASB has incorporated all existing text and considers appendices on historical cost, [Appendix C](#), 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 and how it might be written.

If not, please provide your reasons, the other option that you support instead, and your reasons for supporting that other option.

#### Preliminary View—Chapter 2.2 (following paragraph 29)

Fair value guidance is aligned with IFRS 13, taking into account public sector financial reporting needs and the special characteristics of the public sector. The IPSASB considers the Fair Value appendix, [Appendix B](#), 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 and how it might be written.

#### Preliminary View—Chapter 2.3 (following paragraph 31)

Cost of fulfilment guidance is based on the concepts developed in the Conceptual Framework, expanded based on its application in IPSAS. The IPSASB considers the Cost of Fulfilment appendix, [Appendix A](#), 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 and how it might be written.

**Preliminary View—Chapter 2.4 (following paragraph 31)**

Replacement cost guidance is based on the concepts developed in the Conceptual Framework, expanded based on its application in IPSAS. The IPSASB considers the Replacement Cost appendix, [Appendix B](#), 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 and how it might be written.

**Preliminary View—Chapter 2.5 (following paragraph 32)**

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 list any other definitions that you consider should be included in the list and the reasons for your proposals.

**Preliminary View—Chapter 2.5 (following paragraph 34)**

The Illustrative ED provides application guidance on the four measurements bases most widely applied in IPSAS. Where other guidance is required in the future, additional appendices will be added and the core Illustrative ED will be amended.

Do you agree with approach taken by the IPSASB?

If not, please provide your reasons, stating clearly what you consider needs to be changed and how it might be written.

**Preliminary View—Chapter 3.1 (following paragraph 3.26)**

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 provide your reasons, state which option you support, and your reasons for supporting that option.

**Preliminary View—Chapter 3.2 (following paragraph 3.35)**

Transaction costs in the public sector are defined as follows:

**Transaction costs** are incremental costs that are directly attributable to the acquisition, issue or disposal of an asset or liability. An incremental cost is one that 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.

**Preliminary View—Chapter 3.3 (following paragraph 3.40)**

The IPSASB's view is that transaction costs should be addressed in the 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.

**Preliminary View—Chapter 3.4 (following paragraph 3.51)**

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

- Excluded in the valuation of liabilities measured at cost of fulfillment;
- 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.

**Preliminary View—Chapter 3.5 (following paragraph 3.51)**

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

- Included in the valuation of liabilities measured at cost of fulfillment;
- 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.

**Specific Matter for Comment—Chapter 3.1 (following paragraph 3.61)**

The market value measurement methodology is currently a neutral methodology that can be applied in either calculating current entry or exit values. Do you agree a current value measurement methodology continues to be required that allows for the entry and exit value measurements? If not, please provide your reasons, the other bases that you support, and your reasons for supporting those other bases.

**Specific Matter for Comment—Chapter 4.1 (following paragraph 4.23)**

Do you agree the methodology developed by the IPSASB in Subsequent Measurement: Assets Flow Chart ([Diagram 4.1](#)) and Subsequent Measurement: Liabilities Flow Chart ([Diagram 4.2](#)) provides a useful and appropriate basis for the IPSASB to review measurement requirements in existing IPSAS and developing new IPSAS by identifying the four primary measurement bases:

- Fair value;
- Historical cost;

- Replacement cost; and
- Cost of fulfillment.

If not, should the IPSASB consider other factors when reviewing measurement requirements in existing IPSAS and developing new IPSAS? If yes, what? Please provide your reasons, the other bases that you support, and your reasons for supporting those other bases.

## PUBLIC SECTOR MEASUREMENT

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**Project Overview**

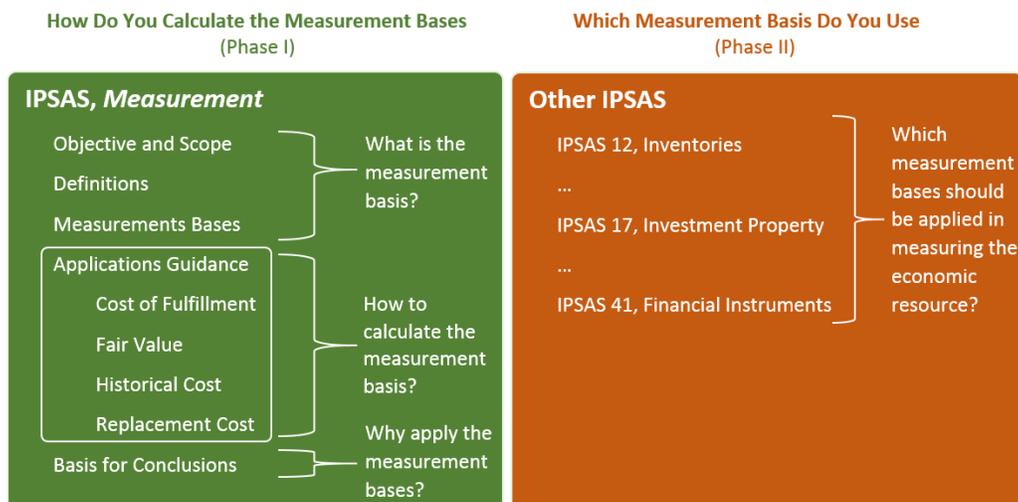
**Why is this Project Being Undertaken?**

1. The IPSASB completed *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) in 2014. The Conceptual Framework establishes the concepts that underpin financial reporting, which the IPSASB applies in developing IPSASs.<sup>1</sup>
2. After completing the Conceptual Framework, the IPSASB recognized a need to address measurement requirements in IPSAS. In their responses to the IPSASB’s 2014 Strategy and Work Plan consultation, constituents supported a Public Sector Measurement project.
3. The Public Sector Measurement project began in 2017, with the rationale that measurement requirements in IPSAS should be amended to better align them with the Conceptual Framework’s measurement concepts. The project’s objectives are to:
  - (a) Issue amended IPSAS with revised requirements for measurement at initial recognition, subsequent measurement, and measurement-related disclosure, where necessary;
  - (b) Provide more detailed guidance on the implementation of commonly used measurement bases, and the circumstances under which these measurement bases will be used; and
  - (c) Address transaction costs and borrowing costs.

**What are the Outputs of this Project?**

4. IPSAS, *Measurement*, will identify the most commonly used measurement bases for measuring assets and liabilities for public sector entities applying IPSAS. The standard will provide definitions and explanatory text for those measurement bases, i.e. it answers the “what?” question for each measurement basis. The appendices to IPSAS, *Measurement*, will have application guidance on how to derive those measurement bases. The Basis for Conclusions explains why the IPSASB decided particular issues in the way that they did, as they developed IPSAS, *Measurement*.

**Diagram 1: Relationship between IPSAS, *Measurement*, and Other IPSASs**



<sup>1</sup> The Conceptual Framework does not establish authoritative requirements for financial reporting by public sector entities that adopt IPSASs, nor does it override the requirements of IPSASs or RPGs.

5. Other IPSASs will continue to address the choice of a measurement basis, i.e. they will address the “which measurement basis?” question. For example, IPSAS 17, *Property, Plant and Equipment*, provides requirements for which measurement bases to use when accounting for property plant and equipment, while IPSAS 41, *Financial Instruments*, identifies the appropriate measurement bases when measuring financial instruments.

**How will this Project be Developed?**

6. Below, Diagram 2 illustrates the process to develop IPSAS, *Measurement*. The Board is presently in Phase One, represented by the orange arrow on the left.

**Diagram 2: The Process from Consultation to Approved IPSAS, *Measurement***



*Phase One – Consultation Paper Stage*

7. In the first phase of this project, the IPSASB outlined its preliminary views on measurement in the public sector. In this single document, the IPSASB has provided both a consultation paper (CP) and an initial draft of an IPSAS (i.e. an illustrative exposure draft (ED)).

**Diagram 2a: The Process from Consultation to Approved IPSAS, *Measurement* (Phase One)**



<p><b>Consultation Paper</b></p> <p><i>What measurement bases?</i></p> <ul style="list-style-type: none"> <li>Conceptual Framework context</li> <li>Sources of proposed Application Guidance</li> </ul> <p><i>How to implement bases</i></p> <ul style="list-style-type: none"> <li>Comparison with valuation standards and GFS</li> <li>Borrowing costs</li> <li>Transaction costs</li> </ul> <p><i>Which bases to apply</i></p> <ul style="list-style-type: none"> <li>Approach to consequential amendments</li> </ul>	<p><b>Illustrative ED, <i>Measurement</i></b></p> <ul style="list-style-type: none"> <li><b>What</b>—Definitions of measurement bases</li> <li><b>How</b>—Application guidance</li> <li><b>Why</b>—Basis for conclusions</li> </ul>
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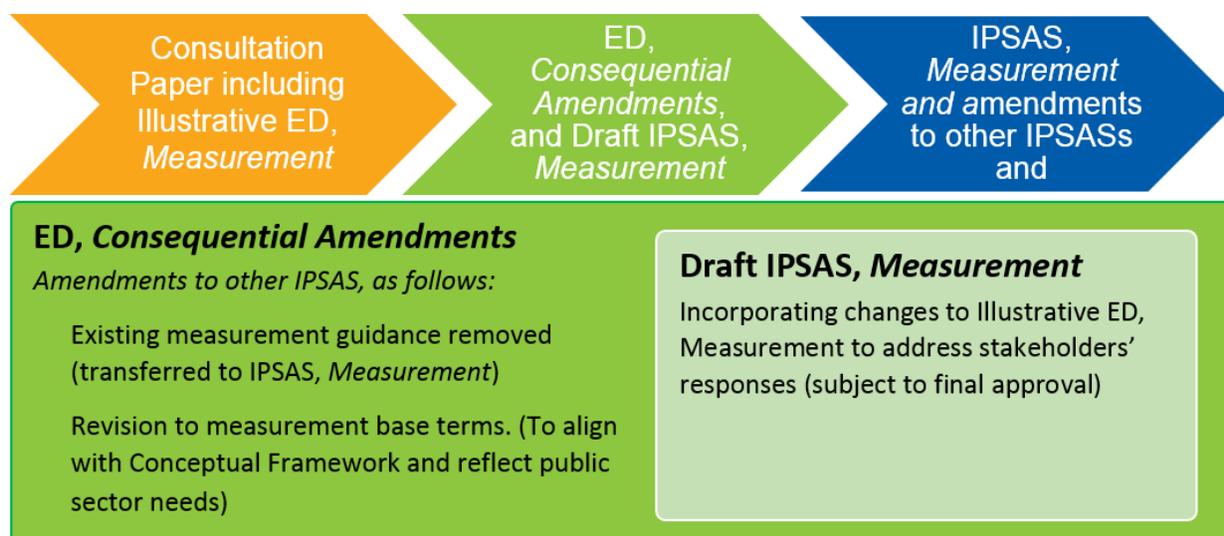
8. The IPSASB is pioneering this new approach in order to improve how it consults with its constituents. This approach provides both:
  - o A concepts-based discussion, in the **Consultation Paper**, which identifies areas where the IPSASB has reached preliminary views; and

- An **Illustrative Exposure Draft**, which illustrates what the IPSASB thinks the final product will look like, given its preliminary views. This provides constituents with a clearer view of the IPSASB’s direction of travel, by showing what the ideas in the CP would result in as a draft IPSAS.
9. The Illustrative ED, *Measurement*, defines measurement bases, and has generic application guidance for their derivation.
  10. The IPSASB is asking for constituents’ views on both the Consultation Paper and the Illustrative Exposure Draft.

*Phase Two – Exposure Draft Stage*

11. After the IPSASB reviews the comments received on both the CP and the Illustrative ED the next step—Phase Two represented by the middle, green arrow—will be to develop and approve:
  - (a) A preliminary version of IPSAS, *Measurement*, which will be issued as “IPSAS, *Measurement* [Draft]”; and
  - (b) An exposure draft with consequential amendments to other IPSASs.

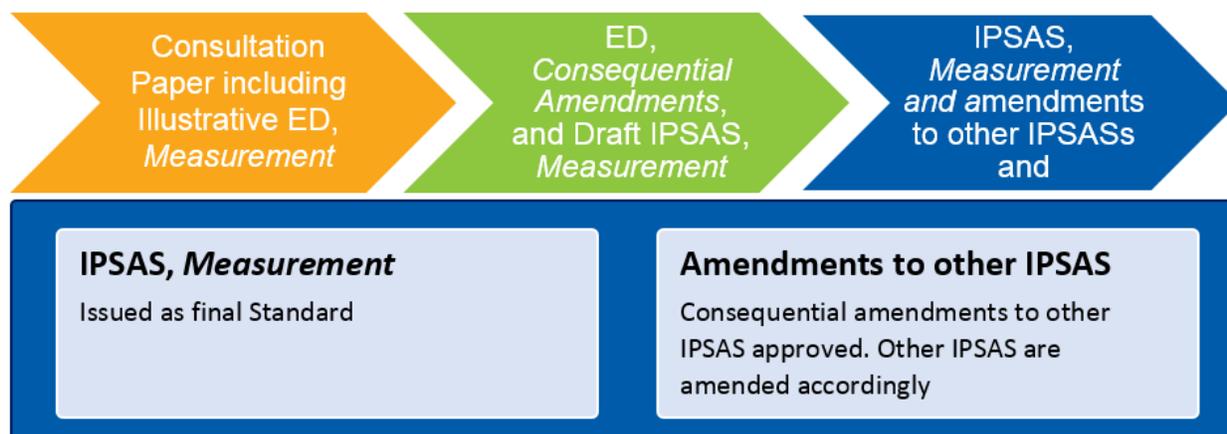
**Diagram 2b: The Process from Consultation to Approved IPSAS, *Measurement* (Phase Two)**



12. Both documents—IPSAS, *Measurement* [Draft] and ED, *Consequential Amendments*—will then be published. The IPSASB’s constituents will see how their comments have contributed to IPSAS, *Measurement*, and provide comments on the consequential amendments to other IPSAS, in ED, *Consequential Amendments*.

*Phase Three – Final Pronouncements*

13. The IPSASB will then review the responses received from constituents on Draft IPSAS, *Measurement*, and develop the final version of IPSAS, *Measurement*, for issuance. The consequential amendments to other IPSASs will also be reviewed in light of the responses received from constituents. The blue arrow on the right in Diagram 3 represents the final step in this process. After the IPSASB revises the two documents in light of constituents’ responses, IPSAS, *Measurement*, will be issued as a final standard. Other IPSAS will be amended, as required, through finalized consequential amendments.

Diagram 2c: The Process from Consultation to Approved IPSAS, *Measurement* (Phase Three)**Limited Scope review of the Conceptual Framework**

14. In progressing the Public Sector Measurement project, and in the development of the CP and Illustrative ED, the Board concluded it was necessary to revisit a portion of its Conceptual Framework through the limited-scope review.
15. This limited scope review will consider developments in the IASB Framework following the approval of the IPSAS Framework and modifications warranted by applications of the IPSAS Framework in practice. The project will consider a number of modifications related to measurement.
16. The Board plans to begin this Limited-Scope Review in late 2019 or 2020.

## Chapter 1: What are the Conceptual Framework Requirements?

- 1.1. The Conceptual Framework discusses measurement in Chapter 7, *Measurement of Assets and Liabilities in the Financial Statements*. Chapter 7 establishes the objective of measurement, which addresses the selection of measurement bases.

### Selection of Measurement Bases

- 1.2. The objective of measurement is:  
To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.
- 1.3. The Conceptual Framework identifies the measurement bases from which a selection should be made. Those are:

Measurement Bases for Assets	Measurement Bases for Liabilities
Historical cost	Historical cost
Market value	Cost of fulfillment
Replacement cost	Market value
Net selling price	Cost of release
Value in use	Assumption price

- 1.4. The Conceptual Framework provides guidance on selection, by discussing each measurement basis in terms of:
- The information it provides about the cost of services, operating capacity and financial capacity (i.e. achievement of the objective of measurement); and
  - The extent to which the information provided is likely to meet the qualitative characteristics taking into account the constraints.

### Factors to Consider when Selecting a Measurement Basis

- 1.5. The Conceptual Framework identifies factors for consideration when selecting a measurement basis. The factors identified include:
- The nature of a measurement basis, and specifically whether it:
    - Provides an entry or exit value;
    - Is observable in a market (or not); and
    - Is entity-specific (or not).
  - Factors related to the nature and circumstances of the asset/liability, for example, whether:
    - Assets were acquired (or liabilities incurred) in a non-exchange transaction.

- (ii) Assets are held to provide services (non-cash-generating assets), to generate a commercial return (cash-generating assets), and/or for trading or sale.
  - (iii) Assets are specialized, where they have been created or adapted for a particular purpose. Their specialization may relate to their design, location, specification, size or any combination of these factors. These factors are specific to the service being provided, and as a consequence there may be no commercial use against which the value of the asset can be benchmarked.
  - (iv) There are restrictions on what the entity is able to do with the asset/liability.
- (c) Whether a market exists for similar assets and liabilities and the type of market: for example, is it open, active and orderly.

## Chapter 2: How has the Illustrative ED been developed?

- 2.1. The Board reached a number of preliminary views as they advanced the project. In order to reflect these views, [ED, Measurement](#), was developed to illustrate the final product, given the decisions to date. The idea is to provide constituents with a clearer view of the IPSASB's direction of travel, by reflecting the ideas in the CP as a draft IPSAS. By being more transparent about where the IPSASB's discussions, and the ideas in the CP, are leading, the IPSASB hopes to get better feedback on those ideas.
- 2.2. When IPSAS were first developed, they used measurement bases developed for private sector financial reporting and adapted them for the public sector. The IPSASB took into account public sector financial reporting needs and the special characteristics of the public sector discussed in the Preface to the Conceptual Framework. Financial statement measurement requirements in IPSAS now need to be better aligned with the measurement concepts in the Conceptual Framework.

### Bases of Measurement

- 2.3. The Conceptual Framework identifies eight measurement bases. However, only four measurement bases are applied in IPSAS. These four measurement bases are identified in the Illustrative ED and make up the majority of the guidance developed in the document.

Figure 2.1 – Measurement Bases in the Illustrative ED

Measurement Basis	Identified in Conceptual Framework	Guidance exists in IPSAS
Cost of fulfilment	Yes	No
Fair value	No	Yes
Historical cost	Yes	Yes
Replacement cost	Yes	Yes

- 2.4. The Illustrative ED provides definitions and explanatory text for these measurement bases, i.e. it answers the “what?” question for each measurement basis. Accompanying the Illustrative ED are appendices with application guidance on how to derive those measurement bases.

### Source of Guidance

- 2.5. Guidance for the measurement bases identified in Figure 2.1 was derived from a number of sources. Where a measurement basis was identified in the Conceptual Framework and guidance existed in IPSAS, that guidance was carried over to the Illustrative ED. When the measurement basis was identified in the Conceptual Framework and there was limited accompanying guidance in IPSAS, principles were developed expanding on existing measurement concepts in the Conceptual Framework. Finally, as fair value was not identified as a measurement basis in the Conceptual Framework, guidance for the Illustrative ED was developed based on IFRS 13, *Fair Value Measurement*.
- 2.6. The guidance in the Illustrative ED also takes into account the IPSASB's policies on alignment with International Financial Reporting Standards (IFRS) and reduction of differences between IPSAS and Government Finance Statistics (GFS) reporting guidelines.

*Guidance Existing in IPSAS – Historical Cost*

- 2.7. When the IPSASB first developed IPSAS, a number of standards included robust measurement requirements. Guidance on historical cost is such an example. Principles for historical cost are well defined and well developed in existing IPSAS.
- 2.8. As one of the core objectives of the Public Sector Measurement project is to consolidate guidance on measurement into one IPSAS, where guidance is available in existing IPSAS, as is the case for historical cost, it was carried over directly into the Illustrative ED.
- 2.9. As a significant portion of the historical cost guidance in the Illustrative ED is carried forward from existing IPSAS, removing that guidance from the existing standards will be assessed as part of Phase II of the project and highlighted in the ED, *Consequential Amendments*.

**Preliminary View—Chapter 2.1**

Guidance on historical cost should be derived from existing text in IPSAS. The IPSASB has incorporated all existing text and considers the appendix on historical cost, [Appendix C](#), 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 and how it might be written.

*IFRS 13 – Fair Value*

- 2.10. Fair value is a specified measurement basis in many IPSAS. Since this measurement basis is not identified in the Conceptual Framework, one objective for this project is to consider the use of fair value in IPSAS.
- 2.11. At an early stage in the project, the IPSASB determined that IPSAS should use fair value terminology that is consistent with IFRS 13. The Board also agreed that the objective of measuring the current exit value of an asset or a liability is consistent with the measurement objective that exists in a number of IPSAS. Furthermore, as the fair value measurement requirements are currently being applied in a number of IPSAS, the Board concluded it was appropriate to formalize fair value as a public sector measurement basis and include guidance in the Illustrative ED to support constituents in applying the measurement requirements and aligning public sector fair value guidance with the principles developed in IFRS 13 was considered the most appropriate approach to take.
- 2.12. The fair value guidance incorporated into the Illustrative ED is therefore based on IFRS 13. The IPSASB took into account public sector financial reporting needs and the special characteristics of the public sector and adapted the private sector financial reporting requirements in IFRS 13 for the public sector.
- 2.13. To maintain consistency within the Illustrative ED, only general fair value guidance was included in [Appendix B](#) to the Illustrative ED. Fair value guidance in IFRS 13 specific to a particular transaction type, such as financial instruments, was excluded from the Illustrative ED as the IPSASB plans to incorporate guidance specific to particular IPSAS within that IPSAS. See [Addendum B](#) to this Consultation Paper mapping how the IPSASB proposes each paragraph in IFRS 13 be included in IPSAS.

**Preliminary View—Chapter 2.2**

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 the Fair Value appendix, [Appendix B](#), 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 and how it might be written.

*Expanded Principles – Cost of Fulfillment and Replacement Cost*

- 2.14. An overview of the cost of fulfilment and replacement cost measurement bases are outlined in the Conceptual Framework. These measurement bases are used in a number of IPSAS, however, the IPSAS in which they are used provided limited application guidance in how the measurement bases are applied.
- 2.15. In developing the cost of fulfilment and replacement cost measurement bases for the Illustrative ED, the Board expanded on the existing principles in its Conceptual Framework. This was done by reviewing, and incorporating as appropriate, guidance developed by comparable standards setters and the practical experience gained from IPSASB constituents and those in the valuation community.

**Preliminary View—Chapter 2.3**

Cost of fulfilment guidance is based on the concepts developed in the Conceptual Framework, expanded based on its application in IPSAS. The IPSASB considers the Cost of Fulfilment appendix, [Appendix A](#), 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 and how it might be written.

**Preliminary View—Chapter 2.4**

Replacement cost guidance is based on the concepts developed in the Conceptual Framework, expanded based on its application in IPSAS. The IPSASB considers the Replacement Cost appendix, [Appendix B](#), 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 and how it might be written.

*Definitions*

- 2.16. The definitions applicable to all measurement bases have been located in the core Illustrative ED, with application guidance included in the appendices.

**Preliminary View—Chapter 2.5**

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 list any other definitions that you consider should be included in the list and the reasons for your proposals.

**Measurement Bases Omitted from ED, *Measurement***

2.17. As part of its process of identifying the most commonly used IPSAS measurements bases, the Board noted a number of bases were rarely used. These bases include:

- a. Market value (Paragraphs 7.24–7.36 of the Conceptual Framework);

The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.

See paragraph 3.52 for a separate discussion about the use of market value.

- b. Net selling price (Paragraphs 7.49–7.57 of the Conceptual Framework);

The amount that the entity can obtain from the sale of the asset, after deducting the costs of sale. The net selling price is an entity-specific measure that does not require an open, active and orderly market, or the estimation of a price in such a market, while also deducting the entity’s costs of sale. The net selling price therefore reflects constraints on sale.

- c. Value in use (Paragraphs 7.58–7.68 of the Conceptual Framework);

The present value to the entity of the asset’s remaining service potential or ability to generate 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.

- d. Cost of release (Paragraphs 7.82–7.86 of the Conceptual Framework); and

The amount an entity would have to incur to immediately exit from the obligation. The cost of release is the amount that either the creditor will accept in settlement of its claim, or 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 the lowest amount that would be incurred.

- e. Assumption price (Paragraphs 7.87–7.91 of the Conceptual Framework).

The amount which the entity would rationally be willing to accept in exchange for assuming an existing liability. In the context of an activity that is carried out with a view to profit, an entity will assume a liability only if the amount it is paid to assume the liability is greater than the cost of fulfilment or release—i.e., the settlement amount. Once that assumption price has been received by the entity, the entity has an obligation to its creditor.

Figure 2.2 – Measurement Bases omitted from the Illustrative ED

Measurement Basis	Identified in Conceptual Framework	Guidance exists in IPSAS
<b>Market value</b> (see chapter 3.52 for further discussion)	Yes	No
<b>Net selling price</b>	Yes	No

Measurement Basis	Identified in Conceptual Framework	Guidance exists in IPSAS
Value in use	Yes	Yes <sup>2</sup>
Cost of release	Yes	No
Assumption price	Yes	No

- 2.18. As none of these measurement bases is widely applied in existing IPSAS, the Board concluded it is unnecessary to develop guidance at this time. However, the Board will seek constituent feedback and monitor other measurement bases evolve in practice and develop additional guidance if necessary.

### Preliminary View—Chapter 2.6

The Illustrative ED provides application guidance on the four measurements bases most widely applied in IPSAS. Where other guidance is required in the future, additional appendices will be added and the core Illustrative ED will be amended.

Do you agree with approach taken by the IPSASB?

If not, please provide your reasons, stating clearly what you consider needs to be changed and how it might be written.

<sup>2</sup> Value in Use is applied in IPSAS specifically in the measuring impairment of cash generating and non-cash generating assets. Specific guidance currently exists in IPSAS 21, *Impairment of Non-Cash Generating Assets*, and IPSAS 26, *Impairment of Cash Generating Assets*. As the IPSASB concluded the measurement project should include generic measurement guidance, as opposed to guidance that applies to specific transactions, no additional value in use measurement guidance was considered necessary as part of the public sector measurement project.

### Chapter 3: How will the Illustrative ED need to be Developed Further?

- 3.1. This chapter discusses three areas relating to public sector measurement on which the IPSASB is specifically seeking input on from its constituents:
- (a) Using measurement bases in practice and the relationship of IPSAS with other, non-accounting guidance – in International Valuation Standards (IVS) issued by the International Valuation Standards Council (IVSC), and in the Government Finance Statistics (GFS) Manual;
  - (b) The accounting treatment of borrowing costs; and
  - (c) The accounting treatment of transaction costs.

#### Using the Bases in Practice: relationship with IVSC and GFS

- 3.2. In developing the Illustrative Exposure Draft, the IPSASB reviewed definitions relating to measurement in existing IPSAS and in IFRS 13 and compared these with equivalent definitions or descriptions in IVS and GFS. In particular, the IPSASB considered whether there were concepts in IVS and GFS that may need to be incorporated into IPSAS.
- 3.3. The equivalence table, included in [Addendum A](#), suggests that there is a broad equivalence between IPSAS, IVS and GFS in the discussion of Fair Value and Replacement Cost, which are two measurement bases for which Application Guidance has been drafted in the Illustrative Exposure Draft. There also appears to be some equivalence between the net selling price measurement basis and an IVS Liquidation Value, and between the IPSAS concept of value in use and an IVS Investment Value. The IPSASB will explore these further during the next phase of the measurement project. The IVS valuation approaches of Equitable Value and Synergistic Value may have some relevance to the public sector and will also be examined in the next phase of the project. The IPSASB would welcome any views that constituents might have on these apparent similarities between the three sources of guidance.

#### Borrowing Costs

##### *Capitalization or Expensing of Borrowing Costs*

- 3.4. IPSAS 5, *Borrowing Costs*, defines borrowing costs as interest and other expenses incurred by an entity in connection with the borrowing of funds. It generally requires the immediate expensing of borrowing costs. However, it permits, as an alternative treatment, the capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.
- 3.5. Borrowing costs may be attributable to the initial acquisition of the asset, but are not part of the asset's purchase price or, in the case of construction or production, the prices of material and labor. They are not a characteristic of the asset being valued. They are entity-specific costs, which depend on the entity's financing choices.
- 3.6. The question of how to account for borrowing costs also applies to subsequent measurement, when an entity revalues assets applying a cost-based estimate such as replacement cost. IPSAS application guidance does not address the issue of whether, and if so, how, borrowing costs should be incorporated into the calculation of a cost-based current value.
- 3.7. This section addresses these challenges and proposes a way forward in order to address the accounting for borrowing costs in practice.

*Public Sector Borrowing*

- 3.8. The IPSASB considers that there are significant differences between borrowing in the public and private sectors.
- 3.9. Borrowing in the public sector is often centralized and borrowing requirements are determined for the economic entity as a whole. For example, a national government often borrows on behalf of all of its subsidiary entities, including government departments, hospitals, schools and entities responsible for construction of buildings and infrastructure. While centralized borrowing also occurs in the private sector, the public sector approach is different: borrowing may be for investing activities or, in a situation where governments may budget for a deficit, for financing or operating activities.
- 3.10. Furthermore, governments often borrow at a level to fund their aggregate activities, meaning, borrowings are not attributable to a specific expenditure. Funding allocated to specific programs and entities may be derived from a variety of sources, and consequently it is often difficult to determine whether the acquisition/construction/production of an asset has been financed through external borrowing or from other sources (for example, taxes, grants, etc.). Thus, there is often no meaningful way to attribute borrowing costs to qualifying assets.
- 3.11. However, there are situations where public sector entities borrow specifically to finance capital projects. For example, local governments such as city and district councils may finance their construction of infrastructure (roads, bridges, etc.) through specific external borrowing. In these situations public sector entities are able to attribute borrowing costs to a qualifying asset. Similarly an international development bank such as the World Bank or the European Investment Bank may finance part or all of the construction of a particular infrastructure project undertaken by a public sector entity.

*Options for Treatment of Borrowing Costs*

- 3.12. The IPSASB has identified four options for treatment of borrowing costs for a qualifying asset during the period between the start of acquisition/construction/production and active use, as shown in Table 1 below.

**Table 1: Treatment of Borrowing Costs: Options**

<b>Borrowing costs—<i>acquisition, construction or production of qualifying asset:</i></b>	<b>Option 1</b>	<b>Option 2 (IFRS)</b>	<b>Option 3</b>	<b>Option 4 (GFS)</b>
Directly attributable ► and specifically incurred	Expense or capitalize	Must capitalize	Expense or capitalize	Expense
Directly attributable ► but not specifically incurred	Expense or capitalize	Must capitalize	Expense	Expense
<b>Borrowing costs—<i>interest and other expenses incurred by an entity in connection with the borrowing of funds.</i></b>	Expense	Expense	Expense	Expense

- 3.13. Option 1 is the status quo, and would mean no change to IPSAS 5. This option allows for an entity to choose either to capitalize or expense borrowing costs that are directly attributable to a qualifying asset during its acquisition, construction or production. Direct attribution could involve, for example,

a formula to estimate the fraction of borrowing that logically applies to asset construction activities, as opposed to other operations.

- 3.14. Option 2, which aligns with IAS 23, *Borrowing Costs*, requires capitalization and removes the choice to expense. Capitalization applies only during acquisition, construction or production of the qualifying asset, and the borrowings costs must be directly attributable.
- 3.15. Option 3 requires that the accounting policy choice for capitalization only apply to those borrowing costs that are *both* directly attributable to, *and specifically incurred* for, acquisition, construction or production of a qualifying asset. A choice remains, although the extent of choice is narrower than is the case under Option 1.
- 3.16. Option 4 requires that all borrowing costs, without exception, be expensed and is aligned with GFS.

#### *Discussion of the Four Options*

##### Objective of Measurement

- 3.17. The objective of measurement is to select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes<sup>3</sup>.
- 3.18. Capitalizing borrowing costs applies the time value of money principle to the purchase of assets that take a substantial period of time to get ready prior to use. For example, if an entity were to purchase an asset today for CU100, and it will be ready for use in one year, deferring the payment until the asset is ready for use would require a larger payment as a currency unit today is not worth the same as a currency unit tomorrow. The time value of money principle supports including borrowing costs in the value of the asset as they approximate the amount that would have been paid, had the payment been deferred until the asset is ready for use. Furthermore, capitalization of borrowing costs ensures that expenses are allocated to the reporting period in which they occur, i.e. expensed as the economic benefits and/or service potential of the qualifying asset is consumed. The capitalization accounting policy will, applying this reasoning, better support assessment of the cost of services.
- 3.19. Option 1-3's approach to capitalizing borrowing costs allows an entity to link costs to the asset for which borrowing was incurred. Some argue that this provides useful information for accountability and decision making. If the amount of interest that has been capitalized is disclosed in the notes to the financial statements then users are still able to calculate the total interest costs for the period.
- 3.20. However, capitalization of borrowing costs increases the amount recognized as an asset. Yet there appears to be no relationship between an asset's future economic benefits and/or service potential and the extent of borrowing costs incurred. Therefore, capitalization of borrowing costs appears to incorrectly convey to users of the financial statements that assets financed through borrowing have more service potential or ability to generate economic benefits compared to similar assets held by an entity that does not use debt to finance its asset acquisitions. Capitalization has the result that users of the financial statements may assess an entity's operational capacity and financial capacity as higher than would be the case if no capitalization occurred. With respect to the cost of services, capitalization of borrowing costs defers costs to future periods.
- 3.21. If all borrowing costs are expensed then the interest cost item in the entity's statement of financial performance allows users to see a government's total borrowing cost, with no amount "hidden" in

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<sup>3</sup> Paragraph 7.2 of the Conceptual Framework.

assets. Those users of the financial statements that consider total interest costs to be an important indicator of financial performance will likely prefer Option 4, because it provides them with useful information to hold the entity to account and for decision-making purposes.

#### Public Sector Differences

- 3.22. Where possible the Board has a policy to align with guidance developed by the IASB. However, in circumstances where a public sector difference are identified, departure is considered necessary. As paragraph 3.21 supports expensing borrowing costs from a conceptual perspective, the Board is of the view departure from IFRS is further justified in light of the public sector differences identified:
- (a) In the public sector, borrowing is often centralized and is determined for the economic entity as a whole. This creates challenges in allocating borrowing costs when they are not incurred directly by the entity constructing or developing the asset. Furthermore, the borrowing rate reflects the risks associated with the group entity and not those specific to the individual entity.
  - (b) As outlined in paragraph 3.11 above, debt funding is rarely specific to the construction or development of an individual asset. Borrowings are used to fund a government's activities, one of which is the construction of the asset. As the borrowing is not specific to the asset, funding for the asset comes from a variety of sources which include tax revenues, service fees, debt, etc. Allocating a portion of the borrowings to the asset can therefore be an arbitrary exercise.
- 3.23. While it may be feasible to allocate these borrowings to qualifying assets, the Board is of the view that doing so is unlikely to provide relevant and represent faithful information as allocation would be arbitrary. Any accounting system used to track directly attributable borrowing costs and their application to qualifying assets is likely to be complex and resource intensive. The Board is of the view that the complexity would mean that the costs incurred in capitalizing borrowing costs would be considerable and likely to exceed the related benefits.
- 3.24. The IPSASB noted that requiring, or allowing, entities to capitalize borrowing costs impacts the carrying amount of the asset depending on how an entity decides to finance the purchase. Capitalizing borrowing costs increases the carrying amount of the asset beyond the cost to acquire or develop the asset.
- 3.25. The IPSASB considers that requiring or permitting public sector entities to capitalize borrowing costs do not support achievement of the qualitative characteristics. In particular, capitalizing borrowing costs appears likely to diminish the comparability of information in the financial statements. Given the extent to which judgement is needed for Options 1 to 3, the IPSASB does not consider that these three options would contribute significantly towards achievement of the objectives of financial reporting. Therefore, the IPSASB is of the view expensing borrowing costs (Option 4) will provide more useful information for users' assessments of entities' operational capacity, financial capacity and cost of services. Option 4 will also align borrowing cost measurement under IPSAS with GFS reporting guidelines.
- 3.26. Therefore, the IPSASB's preliminary view is that all borrowing costs should be expensed.

#### **Preliminary View—Chapter 3.1**

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 provide your reasons, state which option you support, and your reasons for supporting that option.

### Transaction Costs

3.27. This section addresses two common challenges public sector entities encounter when accounting for transaction costs:

- (a) Whether the cost meets the definition of a transaction cost; and
- (b) Whether the transaction cost should be included or excluded in the carrying value of the financial statement item.

3.28. Since IPSAS do not provide an explicit conceptual basis for its different accounting treatments of transaction costs, the Board concluded there is scope to improve how IPSAS addresses this.

#### *Transaction Costs - Definition*

3.29. Although the treatment of transaction costs is addressed in several IPSAS (e.g. IPSAS 12, 16, 17, 27 and 31), these IPSAS refer to such costs using different phrases, and generally do not call them 'transaction costs'. IPSAS lacks a general definition of transaction costs that would ensure a consistent meaning for transaction costs across all IPSAS, while also supporting the understandability of IPSAS.

3.30. The only definition exists in IPSAS 41, Financial Instruments<sup>4</sup>. IPSAS 41 defines transaction costs as:

Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

3.31. In considering the applicability of this definition across all IPSAS, the Board considered whether the definition was consistent with concepts developed by comparable global organizations. In doing so the Board compared the definitions applied in International Valuation Standards (IVS), Governmental Finance Statistics (GFS) and International Financial Reporting Standards (IFRS) to evaluate the consistency of those definitions with the existing IPSAS definition in IPSAS 41.

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<sup>4</sup> Paragraph 9, IPSAS 41

IFRS	IVS	GFS
<p>The costs to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability that are directly attributable to the disposal of the asset or the transfer of the liability and meet both of the following criteria:</p> <p>(a) They result directly from and are essential to that transaction.</p> <p>(b) They would not have been incurred by the entity had the decision to sell the asset or transfer the liability not been made.</p> <p>(IFRS 13, Appendix A)</p>	<p>The seller's costs of sale or the buyer's costs of purchase and any taxes payable by either party as a direct result of the transaction (IVS 2017, IVS 104, 210.1)</p>	<p>Costs of ownership transfer are the costs associated with acquiring and disposing of nonfinancial assets (other than inventories). (GFSM 2014 glossary, 8.6)</p>

- 3.32. While the GFS and IVS definitions consider transaction costs from the perspective of an asset, they, as well as the IFRS definition, highlight that transaction costs are a direct result of the transaction – this concept is evidenced in the GFS definition through the cost of ownership transfer.
- 3.33. As the IPSAS 41 definition incorporates the core concept put forward in the IFRS, GFS and IVS definitions of transaction costs, the Board concluded it was appropriate to amend the IPSAS 41 definition of transaction costs to make it applicable to all IPSAS.
- 3.34. In amending the IPSAS 41 definition of transaction costs to make it applicable to all IPSAS, references to financial instruments were removed and replaced with generic asset and liability terms. As such transaction costs are defined as:

Incremental costs that are directly attributable to the acquisition, issue or disposal of an asset or liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the asset or liability.

#### Incremental Interpretation Guidance

- 3.35. To support consistent interpretation in practice, additional interpretive guidance is included in the Illustrative Exposure Draft. It clarifies the proposed definition of transaction costs by including key GFS, IVS and IFRS concepts:
- (a) IFRS – costs to transact in the principal, or most advantageous, market
- Incremental costs are often incurred when entering into a transaction. However, in circumstances where an asset or liability is being measured and no transaction has taken place, for example when the replacement costs of an asset is being measured at a point subsequent to initial recognition, transaction costs will have to be assumed as they have not been incurred. This is also the case when incremental costs will be incurred to exit a transaction, for example costs to sell an asset or costs that may be incurred to close a financing

facility, such as a line of credit. When transaction costs are to be estimated, they are assumed to be incurred in the principal, or most advantageous, market- that is, the market with the greatest volume and level of activity for the asset or liability, or when a principal market does not exist, the market that maximizes the amount that would be received to sell the asset or minimizes the amount that would be paid to transfer the liability.

(b) IVS – direct result of the transaction

Incremental costs are a direct result of the transaction. Transaction costs are an essential feature of the transaction, and they would not have been incurred had the transaction not occurred. For example, costs to operate an asset after it has been acquired could be described as incremental costs because they would not be incurred if the entity had not acquired the asset. However, by clarifying that transaction costs are an essential feature of the transaction itself, operating costs are excluded from the definition of transaction costs.

(c) GFS – cost of ownership transfer

Costs attributable to the acquisition of an asset relate specifically to costs of ownership transfer. Costs incurred prior to transfer (for example, costs to negotiate the transaction), or costs incurred subsequent to the transfer, (for example, borrowing costs), are excluded from the definition of transaction costs.<sup>5</sup>

### Preliminary View—Chapter 3.2

Transaction costs in the public sector are defined as follows:

**Transaction costs** are incremental costs that are directly attributable to the acquisition, issue or disposal of an asset or liability. An incremental cost is one that 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.

#### *Location of Guidance*

3.36. During its review of transaction costs, the Board concluded that, whatever its final view on the treatment of transaction costs, the application guidance in IPSAS, Measurement, and requirements in other IPSASs will need to be coordinated. Otherwise, transaction costs could either be added twice or subtracted twice as a result of the same requirement appearing in both IPSAS, Measurement, and another IPSAS.

3.37. In determining the most appropriate method and location to address transaction costs, the Board consider four options:

- (a) Option 1 – transaction costs are addressed in the measurement IPSAS (i.e., principles for accounting for transaction costs would be outlined for each measurement basis);
- (b) Option 2 – accounting for transaction costs is addressed in individual IPSAS;
- (c) Option 3 – IPSAS would become silent on the accounting for transaction costs;

<sup>5</sup> Whether the examples provided are included in the measurement of the asset or liability is outside the scope of this section.

- (d) Option 4 – Develop a universal principle to be applied across all IPSAS (e.g., exclude all transaction costs from the measurement of the asset or liability).
- 3.38. The Board noted there are benefits associated with pursuing each option. However, the Board noted a significant challenge existed in developing a universal principle for all IPSAS (option 4); the measurement objective differs in each standard, and in some cases even within the standard. For example, if the measurement objective is to present the amount paid to acquire an asset, a universal principle to exclude all transaction costs is inconsistent with that measurement objective. Conversely, a principle to include all transaction costs in the amount paid to acquire an asset is inconsistent with the measurement objective of measuring the amount to sell an asset. While option 4 has the benefit of providing a clear, simple accounting treatment, which can be consistently applied to all transaction costs, regardless of the applicable measurement basis and the circumstances of measurement, and preparers will find this approach straightforward to apply, multiple measurement objectives make this a challenging option to pursue.
- 3.39. Similarly, the Board identified challenges in pursuing options 2 or 3. The Board considers the public sector measurement project an opportunity to address measurement of assets and liabilities in one standard. Ignoring transaction costs, option 3, or developing guidance in each IPSAS, option 2, contradicts the Board's stated objective in pursuing the development of Public Sector Measurement.
- 3.40. Option 1 presents the Board with an ambitious goal; to address transaction costs for all IPSAS in one standard. However, developing holistic measurement guidance located in one IPSAS was an objective of the Board in pursuing this project. The development of a universal definition of transaction costs that applies equally to all IPSAS, as noted in paragraph 3.34, is an encouraging step and supports the view that if transaction costs are the same regardless of the nature of the transaction, guidance can be developed in a consistent manner.<sup>6</sup>

### **Preliminary View—Chapter 3.3**

The IPSASB's view is that transaction costs should be addressed in the 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.

#### *Accounting for Transaction Costs*

- 3.41. As noted in paragraph 3.35(a), transaction costs can arise both when:
- (a) An asset is acquired or a liability is incurred; and
  - (b) An asset is sold or disposed of or a liability is settled or transferred.

<sup>6</sup> Consequential amendments associated with developing holistic transaction costs guidance will be addressed in conjunction with the review of constituent feedback on the measurement proposals in this CP, including those illustrated in ED, *Measurement*.

- 3.42. Financial reporting standards generally emphasize transaction costs incurred when entering the transaction, often requiring that transaction costs be capitalized when initially measuring the cost of an asset, and thus reflected in the amount at which an asset is carried in the financial statements.
- 3.43. This suggests that transaction costs contribute to the value of the asset to the entity. By contrast, economists and investors view transaction costs as expenses that do not add value<sup>7</sup>. They result from market imperfections and are sometimes called “frictional costs”. A market improves if transaction costs reduce.<sup>8</sup>
- 3.44. When accounting for transaction costs, again with an emphasis on costs incurred at entry, IPSAS generally require an entity to capitalize transaction costs for an entry value (see, for example, IPSASs 17 and 31), and deduct transaction costs to derive an exit value (see, for example, IPSAS 27, Agriculture). However, some ambiguity exists. For example:
- (a) IPSAS provides minimal guidance on accounting for transaction costs that will be incurred when an asset is sold or disposed of or a liability is settled or transferred.
  - (b) IPSAS does not state whether the ‘fair value’ (as currently defined in IPSAS) of an asset acquired through a non-exchange transaction includes an estimate of transaction costs.
  - (c) When replacement cost is used, as an appropriate measure for deemed cost or ‘fair value’/current value, IPSAS does not explain whether an estimate of transaction costs should be used to calculate the replacement cost.
  - (d) IPSAS does not explain how to account for future estimates of transaction costs necessary to fulfill the obligations, when measuring non-financial liabilities.
- 3.45. Other globally comparable standard setting organizations, IVS and GFS, generally support the principle that transaction costs be included in the measurement of non-financial assets.

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<sup>7</sup> Economics definition: “The cost associated with exchange of goods or services and incurred in overcoming market imperfections. Transaction costs cover a wide range: communication charges, legal fees, informational cost of finding the price, quality, and durability, etc., and may also include transportation costs.”

<http://www.businessdictionary.com/definition/transaction-cost.html>

<sup>8</sup> See <http://www.investopedia.com/terms/t/transactioncosts.asp>

IVS	GFS
<p>IVS explain that most bases of value represent the estimated exchange price of an asset without regard to the seller's costs of sale or the buyer's costs of purchase and without adjustment for any taxes payable by either party as a direct result of the transaction. (IVS 2017, 210.1)</p> <p>IVS state that the cost approach should capture all of the costs that would be incurred by a typical participant and so transaction costs may be included when valuing assets. (IVS 2017, 70.10)</p>	<p>Transactions costs are called "costs of ownership transfer" in GFS. They are:</p> <p>(a) Included in the cost of acquisition for nonfinancial assets; and</p> <p>(b) Expensed for financial assets and liabilities (GFSM 2014 glossary, 8.6)</p>

- 3.46. In evaluating how transaction costs should be accounted for, IPSAS, GFS and IVS all consider the purpose of the measurement – whether it is a measurement to determine an entry value or an exit value. The Board agreed to continue to evaluate the purpose of the measurement when accounting for transaction costs as the purpose of the measurement is driven by the information a financial statement user requires to make informed decisions.
- 3.47. When an economic resource is measured at an entry value, a financial statement user expects to understand:
- (a) The amount incurred to acquire an asset; or
- The purpose of this amount is to provide users with information about the value of the asset to the entity. This is the amount required to support the provision of services and is specific to the entity. Transaction costs are relevant in this valuation.
- (b) The amount received in order to incur the liability.
- The purpose of this amount is to provide users with information about the consideration received by the entity that created the liability. This is the amount incurred to support the provision of services and is specific to the entity. Transaction costs are relevant in this valuation.
- 3.48. When an economic resource is measured at an exit value, a financial statement user expects to understand:
- (a) The amount that could be received to sell an asset; or
- The purpose of this amount is to provide users with information about how much the entity would receive to hold the asset and earn a stream of income or to sell the asset. The price indicates the amount available to fund services. The costs to enter into the transaction are irrelevant.
- (b) The amount that will be paid to settle a liability.
- The purpose of this amount is to provide users with information about how much the entity would have to pay to settle the liability. The costs to enter into the transaction are irrelevant, but the costs to exit the transaction impact user's decisions.

- 3.49. In evaluating the purpose of the measurement, the Board noted the purpose of measurement was only one factor in determining whether including transaction costs in the measurement of an economic resource was relevant to the user of the financial statements. The timing of when the transaction costs is incurred also has an impact.
- 3.50. Transaction costs incurred in acquiring an asset or incurring a liability are a feature of the transaction which resulted in the asset or the liability. Therefore, in conjunction with whether the measurement basis is an exit or entry measurement:
- (a) The cost of fulfillment of a liability or the fair value of an asset or liability are exit values and costs incurred to enter the transaction do not impact the price received to sell an asset or required to be paid to settle a liability (see paragraph 3.47) ; and
  - (b) The historical cost of an asset or liability and the replacement cost of an asset are entry values where costs to enter into the transaction are relevant (see paragraph 3.47). Although the transaction price is not part of the transaction price, the entity could not have acquired the asset or incurred the liability without incurring the transaction costs.
- 3.51. Transaction costs that would be incurred in selling or disposing of an asset or in settling or transferring a liability are a feature of a possible future transaction. Therefore, in conjunction with whether the measurement basis is an exit or entry measurement:
- (a) The cost of fulfillment of a liability is an exit value where costs incurred to exit the transaction are relevant (see paragraph 3.48(b));
  - (b) Fair value of an asset or liability are exit values where costs incurred to exit the transaction are not relevant to the measurement (see paragraph 3.48); and
  - (c) Historical cost of an asset or liability and replacement cost of an asset do not reflect costs that would be incurred in settling or disposing of the asset or in settling or transferring a liability because they are entry values. As they reflect the costs of acquiring the asset or incurring the liability, costs incurred to exit the transaction are not relevant to the measurement (see paragraph 3.48).

**Figure 3.1 – Accounting for Transaction Costs**

Measurement Basis	Measurement Objective	Accounting for Transaction Costs	
		Entry Costs	Exit Costs
Cost of Fulfillment (Appendix 1 of Exposure Draft)	Exit price	Exclude	Include
Fair Value (Appendix 2 of Exposure Draft)	Exit price	Exclude	
Historical Cost (Appendix 3 of Exposure Draft)	Entry price	Include	Exclude
Replacement Cost (Appendix 4 of Exposure Draft)	Entry price	Include	Exclude

**Preliminary View—Chapter 3.4**

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

- Excluded in the valuation of liabilities measured at cost of fulfillment;
- 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.

**Preliminary View—Chapter 3.5**

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

- Included in the valuation of liabilities measured at cost of fulfillment;
- 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.

**Market Value Compared to Fair Value Measurement**

3.52. One objective for this project is to determine whether the fair value measurement basis is relevant and faithfully represents some assets and liabilities held by public sector entities. The Board identified this as an issue because there are a number of references to the fair value basis in IPSAS. However, the Conceptual Framework does not include fair value as a measurement basis.

3.53. The fair value measurement requirements are most commonly applied in IPSAS that are aligned with IFRS. As these standards were consciously aligned with their IFRS counterparts, the Board agreed, unless a decision was previously made to depart, the measurement principles in aligned standards should be maintained. Said another way, when the term fair value is used in IPSAS, the same meaning as in the private sector should apply. This avoids confusion and supports good quality measurement.

3.54. The International Accounting Standards Board (IASB) issued IFRS 13, *Fair Value Measurement*, in 2011. IFRS 13 defines fair value explicitly as an exit value:

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

3.55. In conjunction with its decision to align public sector fair value measurement requirements with IFRS, the Board developed a fair value appendix in the Illustrative ED. The guidance in [Appendix B](#) aligns the fair value measurement requirements with IFRS, making modifications when public sector financial reporting needs and the special characteristics of the public sector justify departure.

- 3.56. The Illustrative ED's Basis for Conclusions discusses the IPSASB's decision to include fair value—defined to be consistent with the IFRS 13 definition—as a measurement basis relevant to IPSAS. If review of individual IPSAS indicates that fair value is appropriate, then the ED's fair value definition and application guidance will apply.

#### *Market Value*

- 3.57. Market value is defined in the Conceptual Framework as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.<sup>9</sup> This definition is aligned with the pre-IFRS 13 definition of fair value, which is also applied in IPSAS 29, *Financial Instruments: Recognition and Measurement*, which is either an entry value or an exit value.
- 3.58. Given the commonality in the definitions of market value and fair value pre-IFRS 13, as part of the consideration of whether the fair value measurement basis was relevant in the public sector, the Board plan to consider how to reduce the overlap in the two definitions, and more specifically, clarify what differentiates the two bases.
- 3.59. 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. This overlap highlights the need to clarify the differences between fair value and market value. The Board continues to believe this project provides the opportunity to address this issue, and thus confusion by constituents.
- 3.60. The Board maintains there are circumstances where a public sector entity requires the ability to measure an entry value or an exit value when valuing an asset or liability at its current value in order to achieve the measurement objective. For example, depending on whether an entity is holding an asset for operational purposes or for sale impacts whether the measurement objective is to present the current value to replace the asset – an entry value – or the current value to sell the asset – an exit value. As such, the Board continues to support the concepts developed for market value. However, the Board also recognizes the ability to differentiate between market value and fair value is of paramount importance.
- 3.61. The Board has agreed to address this overlap as part of Phase II or the project. The Board will consider a number of options, including:
- (a) Renaming “market value”;
  - (b) Amending the definition of “market value” in order to focus on the entry aspects of the measure; or
  - (c) Removing “market value” as a public sector measurement basis.

As noted in paragraph 3.60, the current view is a current value that uses entry prices in the valuation is necessary in public sector. The Board's current preference is to amend the definition to clarify and differentiate this factor.

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<sup>9</sup> This definition combines the definition of market value for assets and the market value for liabilities from Chapter 7 of the Conceptual framework for simplicity purposes.

**Specific Matter for Comment—Chapter 3.6**

The market value measurement methodology is currently a neutral methodology that can be applied in either calculating current entry or exit values. Do you agree a current value measurement methodology continues to be required that allows for the entry and exit value measurements? If not, please provide your reasons, the other bases that you support, and your reasons for supporting those other bases.

## Chapter 4: Applying the Measurement Principles in the Conceptual Framework to IPSAS

- 4.1. This chapter addresses the issue of how the measurement principles in the Conceptual Framework should be interpreted at standards level. It sets out the methodology the IPSASB proposes to adopt in reviewing measurement requirements in existing IPSAS and developing measurement requirements for new IPSAS.
- 4.2. When discussing the Project Brief, the Board's primary considerations included ensuring the measurement bases:
  - (a) Generate information that achieves the Conceptual Framework's measurement objective, see paragraph 4.9, and qualitative characteristics while taking account of the constraints on information in general purpose financial statements;
  - (b) Improve consistency across IPSAS to enhance the comparability of financial statements;
  - (c) Bring the definition of fair value in IFRS 13, *Fair Value Measurement*, into the IPSASB's literature to the extent it is applicable to specific transactions and balances<sup>10</sup> in line with the Board's approach to achieving alignment with IFRS; and
  - (d) Reduce unnecessary differences between IPSAS and Government Finance Statistics (GFS) reporting guidelines.

### Measurement Methodology

- 4.3. The methodology, as outlined in the Subsequent Measurement: Assets Flow Chart, [Diagram 4.1](#), and the Subsequent Measurement: Liabilities Flow Chart, [Diagram 4.2](#), is based on the measurement principles in Chapter 7 of the IPSASB's Conceptual Framework.<sup>11</sup> The methodology takes a broad, strategic approach when identifying the appropriate measurement basis when subsequently measuring assets and liabilities, rather than an overly detailed, complex technical approach.
- 4.4. The methodology is developed to assist the Board when reviewing existing IPSAS and developing new IPSAS by providing a bridge between those principles in the Conceptual Framework and how they should be applied throughout IPSAS. Furthermore, the flow charts will act as a tool in linking the public sector measurement project to the Board's committed limited scope review of the Conceptual Framework.
- 4.5. The Board expects to use these flow charts flexibly. Any 'answer' that the flow chart suggests in relation to a measurement basis for a particular type of asset or liability will be tested against the considerations outlined in paragraph 4.2. For example:

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<sup>10</sup> The Board believes it is important that global standard setters use the same term with the same meaning. The IPSAS definition of "fair value" pre-dates the IFRS 13 definition. The IPSASB's work since developing the Conceptual Framework has demonstrated that "fair value" as defined in IFRS 13 is appropriate for many public sector transactions (particularly financial instruments), but there are other transactions where this is not the case. The IPSASB will therefore evaluate all references to 'fair value' in the literature and determine whether the IFRS 13-based definition is appropriate or whether an alternative measurement basis should be adopted.

<sup>11</sup> In addition to applying the principles in the Conceptual Framework, the Flow Charts also incorporate the IPSASB's decision to incorporate fair value measurement to the extent it is applicable to specific public sector transactions and balances.

- a. Existing IPSAS – applying the Subsequent Measurement: Assets flow chart, [Diagram 4.1](#), to inventories yields a result that inventories are measured at replacement cost if the inventory is held for operational capacity and the entity is assessing the cost of service in current value terms. However, the flow chart requires the Board further consider whether replacement cost fairly presents the item or whether another measurement basis more accurately reflects the value of inventory in practice, in this case net realizable value. Additional information on the Board’s review process is included in paragraphs 4.6 to 4.8; or
- b. Future projects – applying the methodology to future projects requires the measurement basis to be assessed applying the flow charts. Unless the economic substance is better represented by another measurement basis, it is presumed the measurement basis outlined in the flow charts will be applied. For example, as measurement guidance is developed for the Board’s Heritage project, assets are presumed to be measured at either historical cost, replacement cost or fair value. However, where the Board concludes the economic substance of the transaction is more fairly presented by a measurement basis other than what is included in the flow charts, the Board applies an alternative measurement basis and outlines the reasons for doing so.

The Board considers that applying the flow charts will assist in facilitating a structured approach when reviewing measurement requirements in existing IPSAS and developing new IPSAS. The flow charts will also provide constituents with a better understanding of the Board deliberations when providing future requirements and guidance on the selection of different measurement approaches.

#### **Application of the Measurement Methodology**

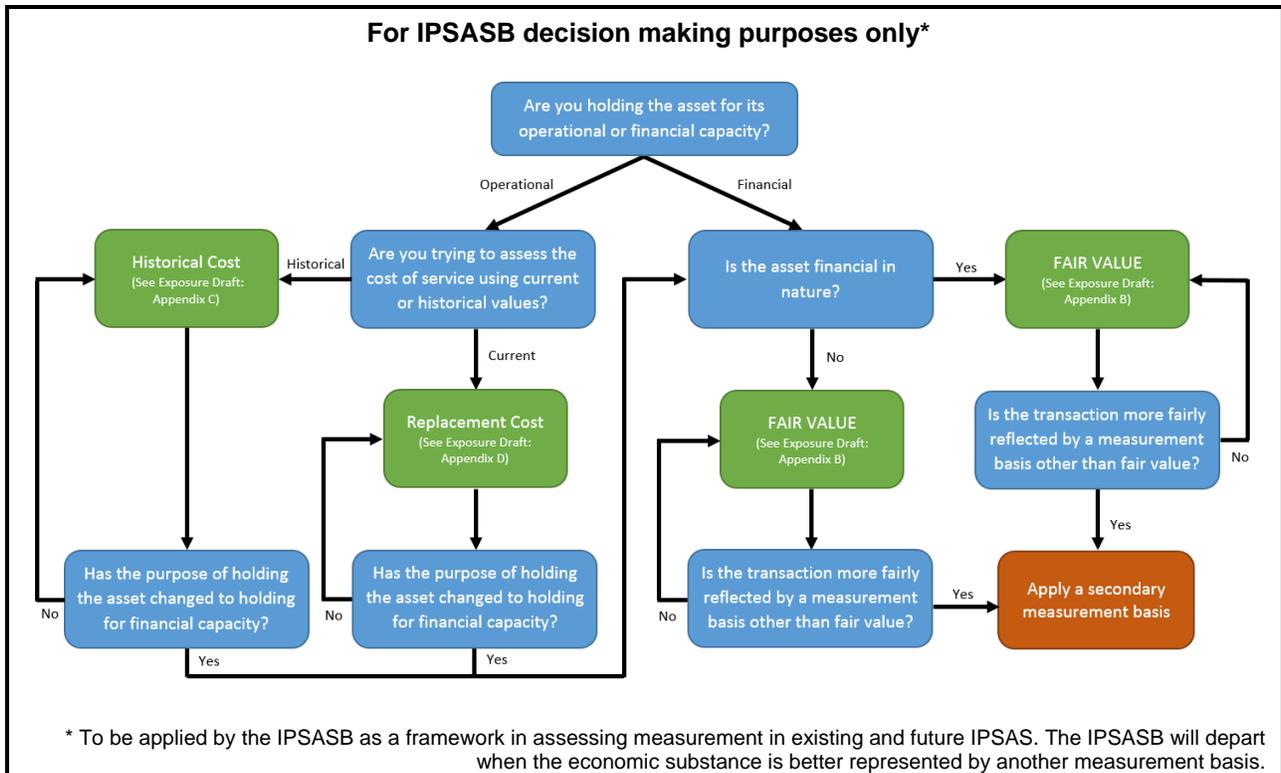
- 4.6. The Board will review the measurement requirements in each IPSAS using the flow charts to assist this process. Where the measurement requirements in existing IPSAS are consistent with the measurement bases outlined in the flow charts, as is the case for financial instruments measured at fair value in IPSAS 41, *Financial Instruments*, no further consideration is necessary. Where the measurement requirements in existing IPSAS are inconsistent with the measurement bases outlined in the flow charts, as is the case for financial instruments measured at amortized cost in IPSAS 41, the Board will perform additional analysis to determine whether the currently prescribed measurement basis, in this case amortized cost, more fairly presents the economic substance of the transaction, or whether a change in the measurement basis is necessary to align with the proposed methodology.
- 4.7. As the measurement methodology is based on the measurement principles in the IPSASB’s Conceptual Framework, is largely in line with existing IPSAS requirements, and is designed to be applied in a flexibly, few changes to the current measurement requirements are expected. However, any changes to IPSAS measurement requirements, or the development of new IPSAS measurement requirements, resulting from the application of this methodology, will be exposed to constituents for comment, in accordance with IPSAS due process.
- 4.8. During development and revision of individual IPSAS the Board will consider a mixture of different factors in order to support the different review objectives in paragraph 4.2.

**Measurement Methodology – Flow Charts**

- 4.9. As noted in paragraph 4.3, these flowcharts are based on the measurement principles outlined in Chapter 7 of the IPSASB’s Conceptual Framework. In determining the appropriate measurement basis, the Conceptual Framework outlines the measurement objective of financial reporting in the public sector is met by providing information that enables users to assess:
- (a) The cost of services provided in the period in historical or current terms;
  - (b) Operational Capacity – the capacity of the entity to support the provision of the services in future periods through physical and other resources; and
  - (c) Financial Capacity – the capacity of the entity to fund its activities.
- 4.10. In achieving these measurement objectives by selecting the appropriate measurement basis, the following factors require consideration:
- (a) Characteristics of the asset or liability; and
  - (b) Contribution to, or subtraction from, future cash flows.
- 4.11. Some assets or liabilities produce cash flows directly, others provide services, and still others are used in combination. The way in which an asset or liability contributes to cash flows depends, in part, on the nature of the entity’s activities. For example, the same asset could be operated to provide medical service, leased to another entity or sold to a third party.

*Subsequent Measurement of Assets*

**Diagram 4.1–Subsequent Measurement: Assets Flow Chart**



*Explanation of Subsequent Measurement: Assets Flow Chart Decision Points*

- 4.12. To support the application of the Subsequent Measurement: Assets Flow Chart, paragraphs 4.13 to 4.18 provide additional information explaining the key decision points.

Are you holding the asset for its operating or financial capacity?

- 4.13. In applying the concepts outlined in paragraph 4.9, the opening question in evaluating the appropriate measurement basis is whether the asset is held for operational or financial capacity.
- (a) Assets held for their financial capacity are primarily held to generate cash inflows to fund the future activities of the entity.
  - (b) Assets held for their operational capacity are held to support the provision of services in current and future periods.

Measurement of Assets Held for Their Financial Capacity

## Is the Asset Financial in Nature?

- 4.14. When the asset is held for its financial capacity, regardless of whether it is financial in nature, it is presumed the asset is held for revenue generation to support the funding of future service delivery (for example, revenue is generated through sale of the asset). When this is the case, the most relevant information to users of the financial statements is presumed to be the amount that could be received to sell the asset – its fair value.

## Is the Transaction more fairly reflected by a Measurement Basis other than Fair Value?

- 4.15. When the economic substance of the transaction is more fairly represented by another measurement basis, the flow chart provides the flexibility to depart from fair value. For example, a historical cost measure, such as amortized cost, which provides relevant and useful information about the asset's likely cash flows, may better present the economic substance of a transaction. This is because fair value assumes the financial instrument will be sold or transferred at the measurement date which is inconsistent with the characteristics of an instrument held with the intention of holding to maturity and collecting its contractual cash flows.

## Secondary Measurement Bases

- 4.16. When the economic substance of the transaction is more fairly represented by another measurement basis, that other measurement basis is applied. For assets held for their financial capacity, secondary measurement bases include:
- (a) Historical cost – historical cost is the consideration given to acquire or develop an asset at the time of its acquisition or development. Historical cost measures provide monetary information about assets, using information derived at least in part, from the price of the transaction when the event that gave rise to them occurred. One way to apply a historical cost measurement basis to financial assets is to measure them at amortized cost.<sup>12</sup> The amortized cost of a financial asset reflects estimates of future cash flows, discounted at a

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<sup>12</sup> The amortized cost of a financial asset or financial liability reflects estimates of future cash flows discounted at a rate that is not updated after initial recognition, unless the asset or liability bears interest at a variable rate. For loans given or received, if interest is receivable or payable regularly, the amortized cost of the loan typically approximates the amount originally paid or received. Therefore, the amortized cost of a financial asset or liability is considered to be a form of historical cost.

rate determined at initial recognition.<sup>13</sup> The amortized cost of a financial asset or financial liability is updated over time to depict subsequent changes, such as the accrual of interest, the impairment of a financial asset or payments.

- (b) Net selling price – net selling price is the amount the entity can obtain from the sale of the asset, after deducting the costs of sale.
- (c) Equity method – the equity method is a method of accounting whereby the investment is initially recognized at cost and adjusted thereafter for the post-acquisition changes in the investor's share of the investee's net assets/equity of an associate or joint venture. The investor's surplus or deficit includes its share of the investee's surplus or deficit and the investor's net assets/equity in its share of changes in the investee's net assets/equity that have not been recognized in the investee's surplus or deficit.

#### Measurement of Assets Held for Their Operational Capacity

Are You Trying to Assess the Cost of Service using Current or Historical Values?

4.17. Where the asset is held for operational capacity, the most relevant information to users of the financial statements is presumed to be the cost to provide services. In order to best reflect the cost of providing these services, the Conceptual Framework acknowledges the cost of services provided in the period can be measured in either historical or current terms. Whether measurement is in historical or current terms fundamentally impacts on the information presented:

- (a) Historical terms - If an asset is measured in historical terms, consumption of the asset gives rise to an expense measured at the historical cost of the asset consumed. As a result, historical cost is a measure of the amount the entity has incurred to provide the services. Information about the amount incurred to provide services is useful in holding entities to account for past decisions. For example, when the cost of property, plant and equipment, such as a roadway, is amortized over its useful life, a historical cost measurement provides users with information as to how much the entity paid for the roadway services to be provided over the useful life of the asset.

Furthermore, assets measured at historical cost provide information that indicates the entity expects the asset will provide sufficient economic benefits and service potential at least to recover the cost of the asset.

- (b) Current terms – Measuring an asset in current terms provides monetary information reflecting the cost at which an equivalent asset could be acquired or created at the measurement date. Measuring in current terms reflects prices prevailing at point in time. As a result, measuring in current terms presents the amount the entity would have to pay at the measurement date to continue to provide the services. Replacement cost fairly presents that information and is useful in understanding the amount required to maintain the provision of the service on an ongoing basis.

While not highlighted in the flow chart, replacement cost can be derived using a number of measurement or valuation techniques. These techniques range from market focused techniques to entity specific, or value in use type techniques. This range of techniques is available because determining the price to replace the asset depends on individual circumstances, and therefore which valuation technique is used will depend on the

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<sup>13</sup> For variable rate instruments, the discount rate is updated to reflect changes in the variable rate.

information that is available (see [Appendix D](#) of the Exposure Draft for further details) and include:

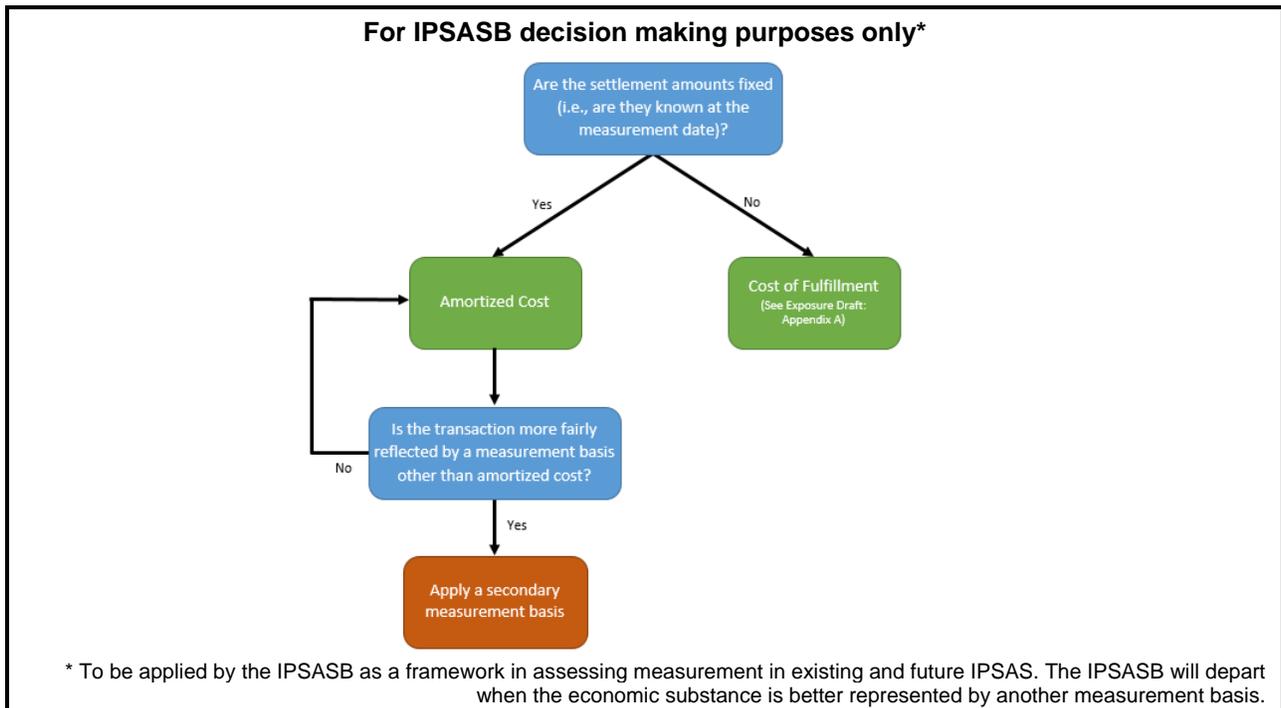
- i. Fair value – Fair value is the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date.
- ii. Value in use – The present value to the entity of the asset’s remaining service potential or ability to generate economic benefits if 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.
- iii. Net selling price – net selling price is the amount the entity can obtain from the sale of the asset, after deducting the costs of sale.
- iv. Net realizable value – Net realizable value is the estimated selling price in the ordinary course of operations, less the estimated costs of completion and the estimated costs necessary to make the sale, exchange, or distribution.

Has the purpose of holding the asset changed to holding for financial capacity?

4.18. Where circumstances change and the asset is no longer held for its operational capacity, the assessment of the appropriate measurement basis shifts to that portion of the flow chart assessing assets held for their financial capacity.

*Subsequent Measurement of Liabilities*

**Diagram 4.2–Subsequent Measurement: Liabilities**



*Explanation of Subsequent Measurement: Liabilities Flow Chart Decision Points*

4.19. The primary measurement objective when measuring a liability is to provide the user of the public sector financial statements with information to allow them to determine the amount required for the entity to satisfy the obligation.

- 4.20. To support the application of the Measurement: Liabilities Flow Chart, paragraphs 4.21 to 4.23 provide additional information explaining the key decision points.

Are the Settlement Amounts Fixed?

- 4.21. In order to best reflect the amount required to satisfy the obligation, the Conceptual Framework principles outlined in paragraph 4.9 acknowledge the liability can be measured in either historical or current terms. Whether a historical or current measurement is used will depend on whether the settlement amount is fixed.

- (a) Liabilities where the settlement amounts are fixed, generally result from transactions where a decision has been made to settle the obligation with cash (for example, financial instruments, as they are a contract to deliver cash).

When the settlement amounts are fixed, the settlement amount is known or can be reliably estimated at the measurement date. When this is the case, the most relevant information to users of the financial statements is presumed to be the price of the transaction derived at the date of the event that gave rise to the liability – historical cost. Measuring a liability in historical terms informs the user that the entity expects that the value of the obligation will not be more than the value of the consideration received. As such the value of the liability is no more than the carrying amount of the liability measured on a cost basis. Applying a historical cost measurement basis to liabilities when the expected cash outflows are known is best represented by applying amortized cost as it reflects estimates of future cash flows discounted at a rate that is not updated after initial recognition, unless the asset or liability bears interest at a variable rate.

When the economic substance of the transaction is more fairly represented by another measurement basis, the flow chart clearly outlines the ability to depart (see paragraph 4.22).

- (b) For liabilities where the settlement amounts are not fixed, but instead arise from the operations of the entity, the Flow Chart requires a cost of fulfillment<sup>14</sup> approach. The approach is appropriate when the liability amount and method of settlement has yet to be determined (for example, decommissioning liabilities as the liability will be settled in a future period and how it will be settled has not been determined).

When this is the case, the settlement amount is unknown at the measurement date. Measuring the liability in current terms, or the cost of fulfillment, reflects this uncertainty to the users of the financial statements.

Amortized Cost – Secondary Measurement Bases

- 4.22. When the economic substance of the transaction is more fairly represented by another measurement basis, the flow chart clearly outlines the ability to depart. For example, when the value of a financial liability changes in response to an underlying foreign exchange rate (for example, a contract to purchase a foreign currency at a future date), fair value<sup>15</sup>, which provides relevant and useful information about the current amount required to extinguish a liability, may

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<sup>14</sup> Cost of fulfillment is the costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner.

<sup>15</sup> Fair value is the price that would be received to transfer an asset in an orderly transaction between market participants at the measurement date.

better present the economic substance of the transaction. This is because amortized cost assumes the financial instrument will be held to collect the instrument's cash flows which may be inconsistent with the characteristics of an instrument held to acquire a foreign currency at a specified rate.

#### Cost of Fulfillment – Secondary Measurement Bases

- 4.23. In developing guidance on the cost of fulfillment, the Board considered whether circumstances existed where another measurement basis better represented the economic substance of the transaction. No circumstances were identified.

#### **Specific Matter for Comment—Chapter 4.1**

Do you agree the methodology developed by the IPSASB in Subsequent Measurement: Assets Flow Chart ([Diagram 4.1](#)) and Subsequent Measurement: Liabilities Flow Chart ([Diagram 4.2](#)) provides a useful and appropriate basis for the IPSASB to review measurement requirements in existing IPSAS and developing new IPSAS by identifying the four primary measurement bases:

- Fair value;
- Historical cost;
- Replacement cost; and
- Cost of fulfillment.

If not, should the IPSASB consider other factors when reviewing measurement requirements in existing IPSAS and developing new IPSAS? If yes, what? Please provide your reasons, the other bases that you support, and your reasons for supporting those other bases.

Addendum A – Equivalence Table

Table 3.1 - International Public Sector Accounting Standards Board Conceptual Framework: The Measurement Models

	IPSAS	IVS 2017	GFS 2014
Historical cost model allowed?	Yes	No	No
Revaluation model allowed?	Yes	Yes	Yes

Table 3.2 - International Public Sector Accounting Standards Board Conceptual Framework: Measurement Bases and Associated Terms and their Equivalents in International Valuation Statistics 2017 and the Government Finance Statistics Manual 2014

	IPSAS	IVS 2017	GFS 2014	Comment
<b>Fair value</b>	<b>The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (IFRS 13)</b>	<b>Fair Value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.</b>	<b>Fair value is a market-equivalent value defined as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s-length transaction.</b>	The three sources appear to be generally aligned.  There do not appear to be any terms in IVS or GFS that need to be imported into IPSAS.
Active market (IFRS 13)	A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.	See, for example, IVS 105, para. 10.8 “Although no one approach or method is applicable in all circumstances, price information from an active market is generally considered to be the strongest evidence of value. Some bases of value may prohibit a valuer from making subjective adjustments to price information from an active market. Price information from an inactive market may still be good evidence of value, but subjective adjustments may be needed.”	See, for example, para. 1.29 “While current market prices are readily available for assets and liabilities that are traded in active markets, valuation according to market-value equivalents is used for valuing assets and liabilities that are not traded in markets, or are traded only infrequently.”	
Active market (IPSAS 21)	An active market is a market in which all the following conditions exist: (a) The items traded within the market are homogeneous; (b) Willing buyers and sellers can normally be found at any time; and (c) Prices are available to the public.			
Entry price (IFRS 13)	The price paid to acquire an asset or received to assume a liability in an exchange transaction.	Description of <a href="#">cost approach</a> and <a href="#">market value</a> use similar ideas.	No equivalent, however, the concept of transaction price includes features of both an entry and exit price. Transactions that	

IPSAS		IVS 2017	GFS 2014	Comment
			involve dumping and discounting represent market prices. Transaction prices for goods and services are inclusive of appropriate taxes and subsidies. A market price is the price payable by the buyer after taking into account any rebates, refunds, adjustments, etc., from the seller (Paragraph 3.110).	
Entry value (Conceptual Framework, para 7.8 to 7.9)	An entry value reflects the cost of purchase for assets and, for liabilities, relates to the transaction under which an obligation is received or the amount that an entity would accept to assume a liability.	Description of <a href="#">cost approach</a> and <a href="#">market value</a> use similar ideas.	No equivalent.	
Exit price (IFRS 13)	The price that would be received to sell an asset or paid to transfer a liability.	Reference to “market approach/exit value” in para. 50.22 IVS 105. Para. 50.24 states that “The market approach/exit value method can be performed in a number of ways, but the ultimate goal is to calculate the value of the asset at the end of the explicit cash flow forecast.”	There are references to “sale price” (e.g. para. 5.88) with respect to assets, but no references to transfer costs or price with respect to liabilities. (Transfer payments related to social benefits has a different meaning.)	
Exit values (Conceptual Framework, para 7.8 to 7.9):	Exit values reflect the economic benefits from sale of an asset and also the amount that will be derived from use of the asset, and, for liabilities, the amount required to fulfil an obligation or the amount required to release the entity from an obligation.	Similar to “market approach/exit value” in IVS 105 para. 50.22.	No equivalent.	
Highest and best use (IFRS 13)	The use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (e.g. a business) within which the asset would be used.	See IVS 104, 140.1-140.5. “Highest and best use is the use, from a participant perspective, that would produce the highest value for an asset. Although the concept is most frequently applied to non-financial assets as many financial assets do not have	No equivalent.	

	IPSAS	IVS 2017	GFS 2014	Comment
		<p>alternative uses, there may be circumstances where the highest and best use of financial assets needs to be considered.”</p> <p>The highest and best use must be physically possible, financially feasible, legally allowed and result in the highest value.</p> <p>If different from the current use, the costs to convert an asset to its highest and best use would impact the value.</p>		
Income approach (IFRS 13)	Valuation techniques that convert future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.	IVS 105, 40.1: The income approach provides an indication of value by converting future cash flow to a single current value. Under the income approach, the value of an asset is determined by reference to the value of income, cash flow or cost savings generated by the asset. <i>income approach methods</i> (IVS 2017, IVS 105, 50.1.) Income approach methods are ways to implement the income approach, and are [all] effectively based on discounting future amounts of cash flow to present value. They are variations of the Discounted Cash Flow (DCF) method.	The “present value of future returns” are defined as: “In some cases, current market prices may be approximated by the present value of the future economic benefits expected from a given asset. Current prices can also be approximated by net present value when there are costs of bringing assets to the market. The economic benefit and costs can be discounted to estimate the net present value of the asset. (Paragraph 7.33)	
Inputs (IFRS 13)	The assumptions that market participants would use when pricing the asset or liability, including assumptions about risk, such as the following: (a) the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model); and (b) the risk inherent in the inputs to the valuation technique. Inputs may be observable or unobservable.	See, for example, IVS 300 para. 20.3, where the reference to “assumptions” appears to have a similar meaning to that of “inputs.”	No equivalent.	

	IPSAS	IVS 2017	GFS 2014	Comment
	<i>Level 1 inputs</i>	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.	See, for example, IVS 105, para. 10.8 for reference to <a href="#">active markets</a> .	No equivalent.
	<i>Level 2 inputs</i>	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.	No equivalent.	No equivalent.
	<i>Level 3 inputs</i>	Unobservable inputs for the asset or liability.	No equivalent.	No equivalent.
	<i>Market-corroborated inputs</i>	Inputs that are derived principally from or corroborated by observable market data by correlation or other means.	See, for example, IVS 105, para. 10.8 for reference to <a href="#">active markets</a> .	See, for example, para. 1.29 “While current market prices are readily available for assets and liabilities that are traded in active markets, valuation according to market-value equivalents is used for valuing assets and liabilities that are not traded in markets, or are traded only infrequently.”
	<i>Observable inputs</i>	Inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.	No equivalent.	The idea of observable market prices is in para. 7.24, which states that “Ideally, observable market prices should be used to value all assets and liabilities in a balance sheet. However, in estimating the current market price for balance sheet valuation, a price averaged over all transactions in a market can be used if the market is one on which the items in question are regularly, actively, and freely traded.
	Market approach (IFRS 13)	A valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets, liabilities or a group of assets and liabilities, such as a business.	See IVS 105, 20.1. The market approach provides an indication of value by comparing the asset with identical or comparable (that is similar) assets for which price information is available.	“Stock positions should be valued at market value—that is, as if they were acquired in market transactions on the balance sheet reporting date (reference date). Market prices are readily available for assets and liabilities that are traded in active markets, most

	IPSAS	IVS 2017	GFS 2014	Comment
			commonly certain financial assets and their corresponding liabilities. (Paragraph 3.113)	
Market participant (IFRS 13)	Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics: (a) They are independent of each other, i.e. they are not related parties as defined in IAS 24, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms. (b) They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary. (c) They are able to enter into a transaction for the asset or liability. (d) They are willing to enter into a transaction for the asset or liability, i.e. they are motivated but not forced or otherwise compelled to do so.	There are references to market participants in several IVS (see, for example, IVS 104, 30.5 and elsewhere in IVS 104.	No equivalence, although there are references to willing buyers and sellers that facilitate market prices for transactions (see for example para. 3.108).	
<i>Most advantageous market</i>	The market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.	No equivalent.	No equivalent.	
Orderly transaction (IFRS 13)	A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (e.g. a forced liquidation or distress sale).	See IVS 104, 160.1: an orderly liquidation describes the value of a group of assets that could be realised in a liquidation sale, given a reasonable period of time to find a purchaser (or purchasers), with the seller being compelled to sell on an as-is, where-is basis.	Reference to the idea of relevant market “Generally, market prices should be taken from the markets where the same or similar items are currently traded in sufficient numbers and in similar circumstances.” (Paragraph 3.111)	
Principal market (IFRS 13)	The market with the greatest volume and level of activity for the asset or liability.	No equivalent.		

	IPSAS	IVS 2017	GFS 2014	Comment
Market value	Market value for assets is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction. Market value for liabilities is the amount for which a liability could be settled between knowledgeable, willing parties in an arm’s length transaction. (CF, para 7.24 and 7.80)	IVS 104, 30.1: “Market Value is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.”	Market prices refer to current exchange value—that is, the value at which goods, services, labor, or assets are exchanged or else could be exchanged for cash (currency or transferable deposits). (Paragraph 3.107)	The three sources appear to be aligned. However, the definitions are very close to the definition of fair value and the terms associated with fair value could be seen as being equally relevant to market value.
Replacement cost	Replacement cost is the optimized depreciated replacement cost of an asset (CF, 7.40, 7.47 and footnote 14).	Generally, replacement cost is the cost that is relevant to determining the price that a participant would pay as it is based on replicating the utility of the asset, not the exact physical properties of the asset. (IVS 105, 70.2)	Written-down replacement cost is the current acquisition price of an equivalent new asset minus the accumulated consumption of fixed capital, amortization, or depletion. (para 3.115)	The definitions of replacement cost (or optimized depreciated replacement cost) and written-down replacement cost appear to align.
Cost approach (IFRS 13)	A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).	See IVS 105, 60.1. The cost approach provides an indication of value using the economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility, whether by purchase or by construction, unless undue time, inconvenience, risk or other factors are involved. The approach provides an indication of value by calculating the current replacement or reproduction cost of an asset and making deductions for physical deterioration and all other relevant forms of obsolescence. See also cost approach method (IVS 2017, IVS 105, 70.1)	“Written-down replacement cost” is “the current acquisition price of an equivalent new asset minus the accumulated consumption of fixed capital, amortization, or depletion.”	
Current replacement cost (IPSAS 12)	The cost the entity would incur to acquire the asset on the reporting date.			

IPSAS		IVS 2017	GFS 2014	Comment
<b>Net selling price</b>	<b>The amount that the entity can obtain from sale of the asset, after deducting the costs of sale. (CF, para 7.49)</b>	See <a href="#">Liquidation Value</a> below	<b>No equivalent.</b>	IVS measurement basis 'Liquidation Value' appears to equate to IPSAS 'Net Selling Price'.  Need to consider further during Phase 2 of the Measurement Project, including the link with fair value.
Costs of disposal (IPSAS 21)	The incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.	Reference to "transaction costs" in para 210.1 includes the phrase: "...the seller's costs of sale..."	See, for example, para 6.60: "Cost of ownership transfer on the disposal of an asset".	
Costs to sell (IPSAS 27)	Costs to sell are the incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes. Disposal may occur through sale or through distribution at no charge or for a nominal charge.			
Fair value less costs to sell (IPSAS 21)	The amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.	See <a href="#">Liquidation Value</a> below.	No equivalent.	
Net realizable value (IPSAS 12)	The estimated selling price in the ordinary course of operations, less the estimated costs of completion and the estimated costs necessary to make the sale, exchange or distribution.	No equivalent.	No equivalent.	
Recoverable amount (IPSAS 17)	The higher of a cash-generating asset's fair value less costs to sell and its value in use.	No equivalent.	No equivalent.	
Recoverable amount (of an asset or a cash-generating unit) (IPSAS 26)	The higher of an asset's or a cash-generating unit's fair value less costs to sell and its value in use.	No equivalent.	No equivalent.	
Recoverable service amount (IPSAS 21)	The higher of a non-cash-generating asset's fair value less costs to sell and its value in use.	No equivalent.	No equivalent.	
<b>Value in Use</b>	<b>The present value to the entity of the asset's remaining service potential or ability to generate economic benefits if it continues to be used, and of the net amount that the entity will</b>	See <a href="#">Investment Value</a> .	<b>No equivalent.</b>	IVS measurement basis 'Investment Value' appears to equate to IPSAS 'Value in Use'.

IPSAS		IVS 2017	GFS 2014	Comment
	<b>receive from its disposal at the end of its useful life. (CF, para 7.58)</b>			Need to consider during Phase 2 of the Measurement Project.
Entity-specific value (IPSAS 17)	An entity-specific value is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.	See definition of 'entity-specific factors' in IVS 104 and 180.1-180.3.	No equivalent.	
Value in use of a cash-generating asset (IPSAS 26)	Flows expected to be derived from the continuing use of an asset and from its disposal at the end of its useful life	No equivalent.	"Assets can be valued at the discounted present value of their expected future returns." (Paragraph 3.125)	
Value in use of a non-cash-generating asset (IPSAS 21)	The present value of the asset's remaining service potential.	No equivalent.	No equivalent.	
Service potential (Conceptual Framework, para 5.8-5.9):	Service potential is the capacity to provide services that contribute to achieving the entity's objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows.	IVS 300, para. 20.5, refers to functional potential, which may have a similar meaning. ("A valuation of plant and equipment will normally require consideration of a range of factors relating to the asset itself, its environment and physical, functional and economic potential.")	No equivalent.	

**Table 3.3 - International Valuation Standards 2017: Measurement Bases and their Equivalents in International Public Sector Accounting Standards and the Government Finance Statistics Manual 2014**

IPSAS	IVS 2017	GFS 2014	Comment
<b>Market Rent</b>	<b>No equivalent in IPSAS.</b>	<b>No equivalent in GFS.</b>	The IVS 'Market Rent' basis is specific to Leases and could usefully

IPSAS		IVS 2017	GFS 2014	Comment
		willing lessor and a willing lessee on appropriate lease terms in an arm's length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.		be considered by the Leases Project.
Equitable Value	No equivalent in IPSAS.	The estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.	No equivalent in GFS.	This may be relevant for some public sector transactions and should be considered further in Phase 2 of the Measurement Project.
Investment Value	See IPSAS definition of Value in Use	The value of an asset to a particular owner or prospective owner for individual investment or operational objectives.	No equivalent in GFS.	See comments against IPSAS basis ' <a href="#">Value in Use</a> '.
Synergistic Value	No equivalent in IPSAS.	The result of a combination of two or more assets or interests where the combined value is more than the sum of the separate values.	No equivalent in GFS.	This may be relevant for some public sector transactions and should be considered further in Phase 2 of the Measurement Project.
Liquidation Value	See IPSAS definition of Net Selling Price	The amount that would be realised when an asset or group of assets are sold on a piecemeal basis. Liquidation Value should take into account the costs of getting the assets into saleable condition as well as those of the disposal activity.	No equivalent in GFS.	See comments against IPSAS basis 'Net Selling Price'.



Addendum B – IFRS 13, *Fair Value Measurement*, Mapped to IPSAS

Topic	IFRS 13 Reference	ED Measurement Reference	Potentially incorporate into the following IPSAS
<b>Objective</b>	1	N/A	
	2	N/A	
	3	N/A	
	4	N/A	
<b>Scope</b>	5	3	
	6	4	
	7	N/A	
	8	5	
<b>Definition of fair value</b>	9	6	
	10	N/A	
<b>The asset or liability</b>	11	B2	
	12	B3	
	13	B4	
	14	B5	
<b>The transaction</b>	15	B6	
	16	B7	
	17	B8	
	18	B9	
	19	B10	
	20	B11	
	21	B12	
<b>Market participants</b>	22	B13	
	23	B14	
<b>The price</b>	24	B15	
	25	B16	
	26	B17	
<b>Highest and best use for non-financial assets</b>	27	N/A	N/A in Public Sector
	28	N/A	N/A in Public Sector
	29	N/A	N/A in Public Sector
	30	N/A	N/A in Public Sector
<b>Valuation premise for non-financial assets</b>	31	N/A	IPSAS 17 or IPSAS 31
	32	N/A	IPSAS 17 or IPSAS 31
	33	N/A	IPSAS 17 or IPSAS 31
<b>Application to liabilities and an entity's own equity - General principles</b>	34	N/A	IPSAS 41
	35	N/A	IPSAS 41
	36	N/A	IPSAS 41
<b>Liabilities and equity instruments held by other parties as assets</b>	37	N/A	IPSAS 41
	38	N/A	IPSAS 41
	39	N/A	IPSAS 41

<b>Liabilities and equity instruments not held by other parties as assets</b>	40	N/A	IPSAS 41
	41	N/A	IPSAS 41
<b>Non-performance risk</b>	42	N/A	IPSAS 41
	43	N/A	IPSAS 41
	44	N/A	IPSAS 41
<b>Restriction preventing the transfer of a liability or own equity</b>	45	N/A	IPSAS 41
	46	N/A	IPSAS 41
<b>Financial liability with a demand feature</b>	47	N/A	IPSAS 41
<b>Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk</b>	48	N/A	IPSAS 41
	49	N/A	IPSAS 41
	50	N/A	IPSAS 41
	51	N/A	IPSAS 41
	52	N/A	IPSAS 41
<b>Exposure to market rates</b>	53	N/A	IPSAS 41
	54	N/A	IPSAS 41
	55	N/A	IPSAS 41
<b>Exposure to the credit risk of a particular counterparty</b>	56	N/A	IPSAS 41
<b>Fair value at initial recognition</b>	57	B18	
	58	B19	
	59	B20	
	60	B21	
<b>Valuation techniques</b>	61	B23	
	62	B24	
	63	B25	
	64	B26	
	65	B27	
	66	B28	
<b>Inputs to valuation techniques - General principles</b>	67	B55	
	68	B56	
	69	B58	
<b>Inputs based on bid and ask prices</b>	70	N/A	IPSAS 41
	71	N/A	IPSAS 41
<b>Fair value hierarchy</b>	72	B59	
	73	B60	
	74	B61	
	75	B62	
<b>Level 1 inputs</b>	76	B63	
	77	B64	
	78	B65	
	79	B66	

	80	B67	
<b>Level 2 inputs</b>	81	B68	
	82	B69	
	83	B70	
	84	B71	
	85	B72	
<b>Level 3 inputs</b>	86	B74	
	87	B75	
	88	B76	
	89	B88	
	90	N/A	
<b>Disclosure</b>	91	N/A	
	92	N/A	
	93	N/A	
	94	N/A	
	95	N/A	
	96	N/A	
	97	N/A	
	98	N/A	
	99	N/A	
<b>Defined terms</b>	Appendix A	6	
<b>Application guidance (introduction)</b>	B1	N/A	
<b>The fair value measurement approach</b>	B2	B1	
<b>Valuation premise for non-financial assets</b>	B3	N/A	IPSAS 17 or IPSAS 31
<b>Fair value at initial recognition</b>	B4	B22	
<b>Valuation techniques - Market approach</b>	B5	B29	
	B6	B30	
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<b>Cost approach</b>	B8	B32	
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<b>Income approach</b>	B10	B34	
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<b>Present value techniques</b>	B12	B36	
<b>The components of a present value measurement</b>	B13	B37	
<b>The components of a present value measurement - General principles</b>	B14	B38	
<b>Risk and uncertainty</b>	B15	B39	

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<b>Discount rate adjustment technique</b>	B18	B42	
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<b>Expected present value technique</b>	B23	B47	
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	B29	B53	
	B30	B54	
<b>Applying present value techniques to liabilities and an entity's own equity instruments not held by other parties as assets</b>	B31	N/A	IPSAS 41
	B32	N/A	IPSAS 41
	B33	N/A	IPSAS 41
<b>Inputs to valuation techniques</b>	B34	B57	
<b>Fair value hierarchy - Level 2 inputs</b>	B35	B73	
<b>Level 3 inputs</b>	B36	B90	
<b>Measuring fair value when the volume of level of activity for an asset or a liability has significantly decreased</b>	B37	B77	
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	C2	N/A	
	C3	N/A	
	C4	N/A	
	C5	N/A	
<b>Amendments to other IFRSs</b>	Appendix D	N/A	

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**Exposure Draft XX**  
**April 2019**  
***Comments due: September 30, 2019***

*Proposed International Public Sector Accounting  
Standard®*

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## Measurement

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets IPSAS® and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

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## REQUEST FOR COMMENTS

This Illustrative Exposure Draft, *Public Sector Measurement*, was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by September 30, 2019.**

Respondents are asked to submit their comments electronically through the IPSASB website, using the "[Submit a Comment](#)" link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. This publication may be downloaded from the IPSASB website: [www.ipsasb.org](http://www.ipsasb.org). The approved text is published in the English language.

### **Objective of the Exposure Draft**

The objective of this Exposure Draft is to define measurement bases that assist in reflecting fairly the cost of services, operational capacity, and financial capacity and how to identify approaches under those measurement bases to be applied through individual IPSASs to achieve the objectives of financial reporting.

**EXPOSURE DRAFT XX, MEASUREMENT****CONTENTS**


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## Objective

1. The objective of this Standard is to define measurement bases that assist in reflecting fairly the cost of services, operational capacity, and financial capacity and how to identify approaches under those measurement bases to be applied through individual IPSASs to achieve the objectives of financial reporting.

## Scope

2. An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this [draft] IPSAS [X] (ED 68) in measuring items.
3. Except as specified in paragraph 4, this IPSAS applies when another IPSAS requires or permits:
  - (a) One or more of the measurement bases defined herein or disclosures about one or more of these measurement bases; and
  - (b) Measurements that are based on one or more of the measurement bases (e.g. market value less costs to sell) or disclosures about those measurements.
4. [Include exceptions here, once identified.]
5. The measurement application guidance described in this IPSAS applies to both initial and subsequent measurement.

## Definitions

6. **The following terms are used in this Standard with the meanings specified:**

**Active market** is a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

**Cost approach** is a valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

**Cost of fulfillment** is the costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner.

**Entry price** is the price paid to acquire an asset or received to assume a liability in an exchange transaction.

**Exit price** is the price received to sell an asset or paid to transfer a liability.

**Expected cash flow** is the probability-weighted average (i.e. mean of the distribution) of possible future cash flows.

**Fair value** is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

**Highest and best use** is the use of a non-financial asset by market participants that would maximize the value of the asset or the group of assets and liabilities (e.g. an operation) within which the asset would be used.

**Historical cost for an asset** is the consideration given to acquire or develop an asset, which is the cash or cash equivalents or the value of the other consideration given, at the time of its acquisition or development.

**Historical cost for a liability** is the consideration received to assume an obligation, which is the cash or cash equivalents, or the value of the other consideration received at the time the liability is incurred.

**Income approach** is valuation techniques that convert future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.

**Inputs** are the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk, such as the following:

- (a) The risk inherent in a particular valuation technique used to measure fair value (such as a pricing model); and
- (b) The risk inherent in the inputs to the valuation technique.

Inputs may be observable or unobservable.

**Level 1 inputs** are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

**Level 2 inputs** are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

**Level 3 inputs** are unobservable inputs for the asset or liability.

**Market approach** is a valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets, liabilities or a group of assets and liabilities, such as an operation.

**Market participants** are buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

- (a) They are independent of each other, i.e. they are not related parties as defined in IPSAS 20, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms.
- (b) They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary.
- (c) They are able to enter into a transaction for the asset or liability.
- (d) They are willing to enter into a transaction for the asset or liability, i.e. they are motivated but not forced or otherwise compelled to do so.

**Market value for assets** is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

**Market value for liabilities** is the amount for which a liability could be settled between knowledgeable, willing parties in an arm's length transaction.

**Market-corroborated inputs** are inputs that are derived principally from or corroborated by observable market data by correlation or other means.

**Most advantageous market** is the market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.

**Non-performance risk** is the risk that an entity will not fulfil an obligation. Non-performance risk includes, but may not be limited to, the entity's own credit risk.

**Observable inputs** are inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.

**Orderly transaction** is a transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (e.g. a forced liquidation or distress sale).

**Principal market** is the market with the greatest volume and level of activity for the asset or liability.

**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.

**Risk premium** is the compensation sought by risk-averse market participants for bearing the uncertainty inherent in the cash flows of an asset or a liability. Also referred to as a 'risk adjustment'.

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

**Transport costs** are the costs that would be incurred to transport an asset from its current location to its principal (or most advantageous) market.

**Unit of account** is the level at which an asset or a liability is aggregated or disaggregated in an IPSAS for recognition purposes.

**Unobservable inputs** are inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

**Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.**

## Measurement

7. **When another IPSAS establishes measurement requirements with reference to one or more of the measurement bases below an entity shall apply the application guidance in the relevant appendix to derive each measurement basis:**
  - (a) Cost of fulfillment;
  - (b) Fair value;

- (c) Historical cost; and
- (d) Replacement cost.

#### *Cost of fulfillment*

Paragraph 8 is based on the IASB's Conceptual Framework paragraph 6.17

8. Cost of fulfillment is the costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner. The cost of fulfillment is the present value of the cash, or other economic resources, that the entity expects to be obliged to transfer as it fulfils a liability. Those amounts of cash or other economic resources include not only the amounts to be transferred to the liability counterparty, but also the amounts that the entity expects to be obliged to transfer to other parties to enable it to fulfil the liability.

Paragraph 9 is based on the IASB's Conceptual Framework paragraph 6.19 and 6.20

9. The cost of fulfillment cannot be observed directly and is determined using cash-flow-based measurement techniques. The cost of fulfillment reflects entity-specific assumptions rather than assumptions used by market participants. In practice, there may be little difference between the assumptions that a market participant would apply and those that the entity uses itself.

Paragraph 10 is based on the IASB's Conceptual Framework paragraph 6.20

10. The cost of fulfillment value reflects the same factors as those reflected in fair value measurement, but from an entity-specific perspective, rather than from a market-participant perspective.

#### *Fair Value*

Paragraph 11, 12 and 13 are based on the IASB's Conceptual Framework 6.10, 6.13 and 6.14

11. Fair value measurement provides monetary information about assets, liabilities and related revenues and expenses, using information updated to reflect conditions at the measurement date. Fair value therefore reflects changes in the values of assets and liabilities since the previous measurement date. Unlike historical cost, the current value of an asset or liability is not derived, even in part, from the transaction or event that gave rise to the asset or liability.
12. Fair value reflects the perspective of market participants. The asset or liability is measured using the same assumptions that a market participant would use when pricing the asset or liability if those market participants act in their economic best interest.
13. In some cases, fair value can be determined directly by observing prices in an active market. In other cases, it is determined indirectly using measurement techniques.

#### *Historical cost*

Paragraph 14 is based on the IASB's Conceptual Framework paragraph 6.4 and IPSASB's Conceptual Framework 7.14

14. Historical cost is an entry, entity-specific value. (The term “historical cost” may also be referred to as the “cost model” or generically as “cost-based measures”). Historical cost measures provide monetary information about assets, liabilities and related revenue and expenses, using information derived, at least in part, from the price of the transaction or event that gave rise to them.

Paragraph 15 and 16 are based on the IPSASB’s Conceptual Framework 7.14 and 7.15

15. Subsequent to initial recognition, this cost may be allocated as an expense to reporting periods in the form of depreciation or amortization for certain assets, as the service potential or ability to generate economic benefits provided by such assets are consumed over their useful lives. Following initial recognition, the measurement of an asset is not changed to reflect changes in prices or increases in the value of the asset.
16. Under the historical cost model the amount of an asset may be reduced by recognizing impairments. Impairment is the extent to which the service potential or ability to generate economic benefits provided by an asset have diminished due to changes in economic or other conditions, as distinct to their consumption. This involves assessments of recoverability. Conversely, the amount of an asset may be increased to reflect the cost of additions and enhancements (excluding price increases for unimproved assets) or other events, such as the accrual of interest on a financial asset.

Paragraph 17 and 18 are based on the IPSASB’s Conceptual Framework 7.71 and 7.72

17. When measuring liabilities under the historical cost model initial measures may be adjusted to reflect factors such as the accrual of interest, the accretion of discount or amortization of a premium.
18. Where the time value of a liability is material—for example, where the length of time before settlement falls due is significant—the amount of the future payment is discounted so that, at the time a liability is first recognized, it represents the value of the amount received. The difference between the amount of the future payment and the present value of the liability is amortized over the life of the liability, so that the liability is stated at the amount of the required payment when it falls due.

Paragraph 19 is based on the IASB’s Conceptual Framework paragraph 6.9

19. One way to apply a historical cost measurement basis to a financial asset or financial liability is to measure them at amortized cost. The amortized cost of a financial asset or financial liability reflects estimates of future cash flows, discounted at a rate determined at initial recognition. For variable rate instruments, the discount rate is updated to reflect changes in the variable rate. The amortized cost of a financial asset or financial liability is updated over time to depict subsequent changes, such as the accrual of interest, the impairment of a financial asset and receipts or payment.

#### *Replacement cost*

Paragraph 20, 21 and 23 are based on the IASB’s Conceptual Framework 6.21 and 6.22

20. 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. The replacement cost of an asset is the cost of an equivalent asset at the measurement date, comprising the consideration that would be paid at the measurement date, plus the transaction costs that would be incurred at the at date.

21. Replacement cost, like historical cost, is an entry value. It reflects prices in the market in which the entity would acquire the asset. However, unlike historical cost, replacement cost reflects conditions at the measurement date.

Paragraph 22 is based on the IPSASB's Conceptual Framework 7.38

22. Replacement cost differs from fair value because it:
- (a) Is explicitly an entry value that reflects the cost of replacing the service potential of an asset;
  - (b) Includes all the costs that would necessarily be incurred in the replacement of the service potential of an asset; and
  - (c) Is entity specific and therefore reflects the economic position of the entity, rather than the position prevailing in a hypothetical market. (For example, the replacement cost of a vehicle is less for an entity that usually acquires a large number of vehicles in a single transaction and is regularly able to negotiate discounts than for an entity that purchases vehicles individually.)
23. In some cases, replacement cost cannot be determined directly by observing prices in an active market and must be determined indirectly by other means. For example, if prices are available for a new asset, the current cost of a used asset might need to be estimated by adjusting the current price of a new asset to reflect the current age and condition of the asset held by the entity.

## Transaction Costs

24. **Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.**
25. Incremental costs are a direct result of the transaction. Transaction costs are an essential feature of the transaction, and they would not have been incurred had the transaction not occurred. For example, while costs to operate an asset after it has been acquired are incremental costs because they would not be incurred if the entity had not acquired the asset, these costs are not transaction costs as they are not a direct result of the transaction.
26. Costs attributable to the acquisition of an asset relate specifically to costs of ownership transfer. Costs incurred prior to transfer (for example, costs to negotiate the transaction), or costs incurred subsequent to the transfer, (for example, borrowing costs), are excluded from the definition of transaction costs.
27. Including transaction costs in the measurement of an asset or liability is dependent on the objective of measurement. Whether an entity is presenting an entry based measurement basis or an exit based measurement basis impacts whether those transaction costs are included or excluded from measurement.
28. Transaction costs can arise both, when an asset is acquired or a liability is incurred, and when an asset is sold or disposed of or a liability is settled or transferred. Transaction costs incurred in acquiring an asset or incurring a liability are a feature of the transaction in which the asset was acquired or the liability was incurred. As such, transaction costs incurred in entering into a transaction are included in entry based measurements bases. Transaction costs that would be incurred in selling or disposing of an asset or in settling a transferring a liability are a future of a possible future

transaction. As such, transaction costs that would be incurred in exiting a transaction are included in exit based measurement bases when the measurement base is entity-specific.

### **Effective Date**

29. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after MMMM DD, YY. Earlier adoption is encouraged. If an entity applies this Standard for a period beginning before MMMM DD, YY, it shall disclose that fact.**
30. When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

## **Appendix A: Cost of fulfillment–application guidance**

*This Appendix is an integral part of [draft] IPSAS [X] (ED XX).*

### **Measurement**

- A1. The objective of cost of fulfillment measurement is to estimate the value of a liability assuming the entity will fulfill its obligation in the least costly manner. A cost of fulfillment measurement requires an entity to determine all the following:
- (a) The particular liability that is the subject of the measurement (consistently with its unit of account).
  - (b) The manner in which the liability will be settled.
  - (c) The liability's expected timing of settlement.
  - (d) The valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the liability.

### **The Liability**

- A2. **A cost of fulfillment measurement is for a particular liability. Therefore, when measuring the cost of fulfillment, an entity takes into account characteristics of the particular liability relevant in determining the cost of fulfillment at the measurement date. Such characteristics include, for example, the following:**
- (a) **The entity's expectations about the amount and timing of the future outflow of resources; and**
  - (b) **The risk that the actual future outflow of resources may ultimately differ from those expected (i.e. a risk premium).**
- A3. The effect on the measurement arising from a particular characteristic will differ depending on how that characteristic would be taken into account by the specific entity.
- A4. The liability measured at its cost of fulfillment might be either of the following:
- (a) A stand-alone liability (e.g., a legal claim against the entity); or
  - (b) A group of liabilities (e.g., decommissioning liabilities associated with a particular asset).
- A5. Whether the liability is a stand-alone liability or a group liabilities for recognition or disclosure purposes depends on the liability's unit of account. The unit of account for the liability shall be determined in accordance with the IPSAS that requires or permits the cost of fulfillment measurement, except as provided in this Application Guidance.

### **The Least Costly Manner**

- A6. **The cost of fulfillment measurement assumes that the liability is settled by the entity in the least costly manner.**

- A7. The cost of fulfillment represents the amount the entity is obligated to incur to settle the liability. This obligation represents the minimum amount an entity will incur assuming the entity completely satisfies its obligation. For example, an entity may have an obligation to restore a parcel of land to its original condition when a temporary road is no longer in use. Even when the entity intends to enhance the parcel of land, the costs of enhancements are beyond the cost to fulfill the minimum obligation of restoring the land to its original condition and therefore are not representative of the cost to fulfill the liability. In cases where an entity intends to fulfill the liability beyond its commitment, guidance in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, should be applied when accounting for amount in excess of the cost to fulfill.
- A8. An entity need not undertake an exhaustive search of all settlement methods to identify the least costly manner of settlement, but it shall take into account all information that is reasonably available. In the absence of evidence to the contrary, the least costly manner of settlement is presumed to be the manner in which the entity has currently selected to release itself from the obligation. For example, if an entity elects to fulfill its decommissioning liability using its own employees, it is presumed this is the least costly manner of settlement, regardless of the entity's ability to contract the decommissioning to third parties.
- A9. The entity must have the ability to access the settlement method that results in the obligation being settled in the least costly manner at the expected settlement date. Because different entities (and operations within those entities) with different activities may have access to a variety of settlement methods, the least costly manner for the same liability might be different for different entities (and operations within those entities). Therefore, the least costly manner shall be considered from the perspective of the entity, thereby allowing for differences between and among entities with different activities.

Paragraph A10 is based on the Conceptual Framework 7.76

- A10. Where fulfillment requires work to be done—for example, where the liability is to rectify environmental damage—the relevant costs are those that the entity will incur. This may be the cost to the entity of doing the remedial work itself, or of contracting with an external party to carry out the work. However, the costs of contracting with an external party are only relevant where employing a contractor is the least costly means of fulfilling the obligation.

Paragraph A11 is based on the Conceptual Framework 7.77

- A11. Where fulfillment will be made by the entity itself, the fulfillment cost does not include any surplus, because any such surplus does not represent a use of the entity's resources. Where the cost of fulfillment amount is based on the cost of employing a contractor, the amount will implicitly include the profit required by the contractor, as the total amount charged by the contractor will be a claim on the entity's resources.

### **Entity-Specific Value**

- A12. **The cost of fulfillment is an entity specific value. An entity shall measure the cost of fulfillment of a liability using the assumptions from the entity's perspective, assuming the entity acts in its own economic best interest.**
- A13. 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).
- A14. When measuring an entity specific value, the estimate of risk premium and the time value of money should be market based. This does not require an entity to use the same assumptions as a market participant, however maximizing the use of market based assumptions is required. For example, when discounting future cash flows, a market based discount rate should be applied where appropriate.
- A15. Accordingly, the risk premium and time value of money in an entity specific measure of a liability should be the amount market participants would apply if their estimates of the amount and timing of the future outflow of resources were the same as the entity's estimates.

### **The Cost that the Entity Will Incur**

- A16. **The cost of fulfillment estimates the cost assuming the entity fulfills its obligation.**
- A17. A cost of fulfillment measurement, both at initial and subsequent measurement, should only incorporate the future outflows of resources the entity expects to incur to satisfy the obligation.
- A18. The price used to measure the cost of fulfilling the liability shall not be adjusted for *transaction costs* incurred to enter into the transaction. Entry-based transaction costs have no impact on the future outflows of resources the entity expects to incur. In contrast, transaction costs that are expected to be incurred, or exit-based, in settling the liability are a future outflow of resources that is relevant in measuring the cost to fulfill the liability and are included in measuring the cost of fulfillment.

Paragraph A19 is based on the Conceptual Framework 7.75

- A19. Where the cost of fulfillment depends on uncertain future events, all possible outcomes are taken into account in the estimated cost of fulfillment, which aims to reflect all those possible outcomes in an unbiased manner.

Paragraph A20 is based on the Conceptual Framework 7.78

- A20. Where settlement of the obligation will not take place for an extended period, the cash flows need to be discounted to reflect the value of the liability at the measurement date using a valuation technique. As a practical expedient, 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.

### **Fulfilling its Obligations**

- A21. **The cost of fulfillment is the cost that the entity expects to incur to settle its obligation in the normal course of operations.**
- A22. **In estimating the cost to settle its obligation in the normal course of operations, the entity assumes the obligation will be fulfilled under the existing terms of the arrangement, with the current counterparty and that the liability will not be transferred to a third party.**

- A23. In estimating the cost of fulfillment the entity takes into account all readily available information at the measurement date under current market conditions in estimating the outflow of resources required to settle the liability at the expected settlement date.
- A24. The cost of fulfillment shall not include the non-performance risk of the entity to settle its obligation. Non-performance risk is the risk that an entity will not fulfil its obligations and it is a characteristic of a liability. However, in estimating the cost of fulfilling a liability, an entity should not include non-performance risk in its estimate.
- A25. A cost of fulfillment measurement is a measure of the value of a liability assuming the entity will fulfil its obligations. As non-performance risk takes into account the effect on the value of a liability of the entity potentially not meeting its obligations it is inconsistent to include in the measure of a liability the possibility that it may not meet its obligations when the cost of fulfillment measurement assumes the liability will be fulfilled in the normal course of operations.

### **Valuation Techniques**

- A26. **An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure the cost of fulfillment, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.**
- A27. The objective of using a valuation technique is to estimate the cost that the entity will incur in fulfilling the obligations represented by the liability at the measurement date under current market conditions. The most commonly used valuation approach when measuring the cost of fulfillment is an income approach. The main aspects of that approach as it relates to the cost of fulfillment are summarized in paragraphs A28–A61.

#### *Income Approach*

- A28. The income approach converts future outflows of resources (e.g., cash flows) to a single current (i.e., discounted) amount. When the income approach is used, the cost of fulfillment measurement reflects current market expectations about those future amounts.
- A29. The most commonly used valuation techniques when measuring the cost of fulfillment are present value techniques. (see paragraphs A30–A61);

#### *Present Value Techniques*

- A30. Paragraphs A31–A61 describe the use of present value techniques to measure the cost of fulfillment. Those paragraphs neither prescribe the use of a single specific present value technique nor limit the use of present value techniques to measure the cost of fulfillment to the techniques discussed. The present value technique used to measure the cost of fulfillment will depend on facts and circumstances specific to the liability being measured and the availability of sufficient data.

#### **The Components of a Present Value Measurement**

- A31. Present value (i.e., an application of the income approach) is a tool used to link future amounts (e.g., cash flows) to a present amount using a discount rate. A cost of fulfillment measurement of a liability using a present value technique captures all the following elements from the entity's perspective at the measurement date:
- (a) An estimate of future outflows of resources for the liability being measured.
  - (b) Expectations about possible variations in the amount and timing of the outflows of resources representing the uncertainty inherent in the outflows of resources.

- (c) The time value of money, represented by the rate on risk-free monetary liabilities that have maturity dates or durations that coincide with the period covered by the outflows of resources and pose neither uncertainty in timing nor risk of default to the holder (i.e., a risk-free interest rate).
- (d) The price for bearing the uncertainty inherent in the outflows of resources (i.e., a risk adjustment).
- (e) Other factors that the entity would take into account in the circumstances.

#### *General Principles*

A32. Present value techniques differ in how they capture the elements in paragraph A31. However, all the following general principles govern the application of any present value technique used to measure the cost of fulfillment:

- (a) Outflows of resources and discount rates should reflect entity specific assumptions that market participants would use when pricing the liability that is expected to be settled through fulfillment of the arrangement.
- (b) Outflows of resources and discount rates should take into account only the factors attributable to the liability being measured.
- (c) To avoid double-counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the outflows of resources. For example, a discount rate that reflects the uncertainty in expectations about future defaults is appropriate if using contractual cash flows of a loan (i.e., a discount rate adjustment technique). That same rate should not be used if using expected (i.e., probability-weighted) cash flows (i.e., an expected present value technique) because the expected cash flows already reflect assumptions about the uncertainty in future defaults; instead, a discount rate that is commensurate with the risk inherent in the expected cash flows should be used.
- (d) Assumptions about outflows of resources and discount rates should be internally consistent. For example, nominal cash flows, which include the effect of inflation, should be discounted at a rate that includes the effect of inflation. The nominal risk-free interest rate includes the effect of inflation. Real cash flows, which exclude the effect of inflation, should be discounted at a rate that excludes the effect of inflation. Similarly, after-tax cash flows should be discounted using an after-tax discount rate. Pre-tax cash flows should be discounted at a rate consistent with those cash flows.
- (e) Discount rates should be consistent with the underlying economic factors of the currency in which the outflows of resources are denominated.

#### *Risk Adjustment*

A33. A cost of fulfillment measurement using present value techniques is made under conditions of uncertainty because the actual resource flows may ultimately differ from those expected. In many cases both the amount and timing of the outflows of resources are uncertain. Even contractually fixed amounts, such as the payments on a loan, are uncertain if there is a prepayment option.

A34. A cost of fulfillment measurement should include a risk based on the entity's estimates of future outflows of resources. The estimated risk premium for a cost of fulfillment measurement is an entity specific assumption. This risk premium does not represent the market risk premium reflecting the amount market participants would demand for bearing the risk that the actual outflows of resources

maybe different from their expectations, however, it does reflect the entity's expectation of the variability in timing and amounts related to the flows of resources. The risk adjustment measures the compensation that the entity would require to make the entity indifferent between:

- (a) Fulfilling a liability that has a range of possible outcomes; and
- (b) Fulfilling a liability that will generate fixed outflows of resources with the same expected present value as the liability being measured.

For example, the risk adjustment would measure the compensation that the entity would require to make it indifferent between fulfilling a liability that has a 50 per cent probability of being CU90 and a 50 per cent probability of being CU110 and fulfilling a liability that is fixed at CU100. As a result, the risk adjustment conveys information to users of financial statements about the entity's perception of the effects of uncertainty about the amount and timing of cash flows that arise from a liability.

- A35. The risk adjustment shall reflect all risks associated with the liability. It shall not reflect the risks that do not arise from the liability, such as general operational risk that relates to future transactions.
- A36. The risk adjustment shall be included in the measurement in an explicit way. Thus, in principle, the risk adjustment is separate from the estimates of future outflow of resources and the discount rates that adjust those outflow of resources for the time value of money. The entity shall not double-count the risk adjustments by, for example, including the risk adjustment implicitly when determining the estimates of future outflow of resources or the discount rates.
- A37. This Appendix does not specify the technique that is used to determine the risk adjustment. However, to meet the objective in paragraph A34, the risk adjustment shall have the following characteristics:
- (a) Risks with low frequency and high severity will result in higher risk adjustments than risks with high frequency and low severity;
  - (b) For similar risks, contracts with a longer duration will result in higher risk adjustments than contracts with a shorter duration;
  - (c) Risks with a wide probability distribution will result in higher risk adjustments than risks with a narrower distribution;
  - (d) The less that is known about the current estimate and its trend, the higher the risk adjustment; and
  - (e) To the extent that emerging experience reduces uncertainty, risk adjustments will decrease and vice versa.

- A38. 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.

#### *Future Outflows of Resources*

- A39. The estimates of outflows of resources used to determine the cost of fulfillment shall include all inflows of resources and outflows of resources that relate directly to the fulfillment of the liability. Those estimates shall:
- (a) Be explicit (i.e., the entity shall estimate those outflows of resources separately from the estimates of discount rates that adjust those future outflows of resources for the time value of

- money and the risk adjustment that adjusts those future outflows of resources for the effects of uncertainty about the amount and timing of those outflows of resources);
- (b) Reflect the perspective of the entity, provided that the estimates of any relevant market variables do not contradict the observable market prices for those variables (see paragraphs A43–A47);
  - (c) Incorporate, in an unbiased way, all of the available information about the amount, timing and uncertainty of all of the inflows of resources and outflows of resources that are expected to arise as the entity fulfils the liability (see paragraph A48); and
  - (d) Be current (i.e., the estimates shall reflect all of the available information at the measurement date) (see paragraphs A49–A53).

#### Uncertainty and the Expected Value Approach

- A40. The expected present value technique uses as a starting point a set of outflows of resources that represents the probability-weighted average of all possible future outflows of resources (i.e., the expected outflows of resources). The resulting estimate is identical to expected value, which, in statistical terms, is the weighted average of a discrete random variable's possible values with the respective probabilities as the weights. Because all possible outflows of resources are probability-weighted, the resulting expected outflows of resources is not conditional upon the occurrence of any specified event (unlike the outflows of resources used in the discount rate adjustment technique).
- A41. In determining the expected outflows of resources an entity must:
- (a) Identify each possible outcome;
  - (b) Make an unbiased estimate of the amount and timing of the future outflows of resources for each outcome;
  - (c) Make an unbiased estimate of the probability of each outcome.
- A42. Paragraph A41 requires the estimate of expected values reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. In practice, this may not need to be a complex analysis. In some cases, relatively simple modelling may be sufficient, without the need for a large number of detailed simulations of scenarios. For example, the identification of scenarios that specify the amount and timing of the outflows of resources for particular outcomes and the estimated probability of those outcomes will probably be needed. In those situations, the expected outflows of resources shall reflect at least two outcomes.

#### Market Variables and Non-Market Variables (Paragraph A39(b))

- A43. This application guidance identifies two types of variables:
- (a) Market variables—variables that can be observed in, or derived directly from, markets (for example, interest rates); and
  - (b) Non-market variables—all other variables (for example, the frequency and severity of natural disasters impacting decommissioning liabilities).

#### Market Variables

- A44. Estimates of market variables shall be consistent with observable market prices at the end of the reporting period. An entity shall not substitute its own estimates for observed market prices except as described in paragraph 66 of Appendix B. In accordance with Appendix B, if market variables need

to be estimated (for example, because no observable market variables exist), they shall be as consistent as possible with observable market variables.

#### Non-Market Variables

- A45. Estimates of non-market variables shall reflect all of the available evidence, both external and internal.
- A46. Non-market external data (for example, national statistics for decommissioning of a nuclear power facility) may have more or less relevance than internal data (for example, internally developed statistics for decommissioning of a nuclear power facility), depending on the circumstances.
- A47. Estimated probabilities for non-market variables shall not contradict observable market variables. For example, estimated probabilities for future inflation rate scenarios shall be as consistent as possible with probabilities implied by market interest rates.

#### Estimating Probabilities of Future Payments (Paragraph A39(c))

- A48. An entity estimates the probabilities associated with future payments under existing contracts on the basis of:
- (a) Information about the known or estimated characteristics of the liability;
  - (b) Historical data about the entity's own experience, supplemented when necessary with historical data from other sources. Historical data is adjusted if, for example:
    - (i) The characteristics of the liability differ (or will differ, for example because of adverse selection) from those of the population that has been used as a basis for the historical data;
    - (ii) There is evidence that historical trends will not continue, that new trends will emerge or that economic or other changes may affect the outflow of resources that arise from the existing liability; or
    - (iii) There have been changes in the entity's practices or procedures that may affect the relevance of historical data to the liability.

#### Under Current Estimates (Paragraph A39(d))

- A49. In estimating the probability of each outflow of resources scenario, an entity shall use all of the available current information at the end of the reporting period. An entity shall review the estimates of the probabilities that it made at the end of the previous reporting period and update them for any changes. In doing so, an entity shall consider whether:
- (a) The updated estimates faithfully represent the conditions at the end of the reporting period; and
  - (b) The changes in estimates faithfully represent the changes in conditions during the period. For example, suppose that estimates were at one end of a reasonable range at the beginning of the period. If the conditions have not changed, changing the estimates to the other end of the range at the end of the period would not faithfully represent what has happened during the whole period. If an entity's most recent estimates are different from its previous estimates, but conditions have not changed, it shall assess whether the new probabilities that are assigned to each scenario are justified. In updating its estimates of those probabilities, the entity shall consider both the evidence that supported its previous estimates and all of the new available evidence, giving more weight to the more persuasive evidence.

A50. The probability assigned to each scenario shall reflect the conditions at the end of the reporting period. Consequently, in accordance with IPSAS 14, *Events after the Reporting Date*, an event that occurs after the end of the reporting period and resolves a condition that existed at the reporting date does not provide evidence of a condition that existed at the end of the reporting period. For example, there may be a 20 per cent probability at the end of the reporting period that a major storm will strike prior to a facility being decommissioned that would increase the cost of decommission. After the end of the reporting period and before the financial statements are authorized for issue, a storm strikes. The outflow of resources under that contract shall not reflect the storm that, with hindsight, is known to have occurred. Instead, the outflow of resources that were included in the measurement are multiplied by the 20 per cent probability that was apparent at the end of the reporting period (with appropriate disclosure, in accordance with IPSAS 14, that a non-adjusting event occurred after the end of the reporting period).

#### Future Events (Paragraph A39(d))

- A51. Estimates of non-market variables shall consider not just current information about the liabilities but also information about trends. For example, technology has consistently improved over long periods decreasing decommissioning costs. The determination of the outflow of resources reflects the probabilities that would be assigned to each possible trend scenario in the light of all of the available evidence.
- A52. Similarly, if the outflow of resources associated with fulfilling the liability are sensitive to inflation, the determination of the outflow of resources shall reflect possible future inflation rates. Because inflation rates are likely to be correlated with interest rates, the measurement of the outflow of resources reflects the probabilities for each inflation scenario in a way that is consistent with the probabilities that are implied by market interest rates.
- A53. When estimating the outflow of resources associated with fulfilling the liability, an entity shall take into account future events that might affect the outflow of resources. The entity shall develop scenarios that reflect those future events, as well as unbiased estimates of the probability weights for each scenario. However, an entity shall not take into account future events, such as a change in legislation, that would change or discharge the present obligation or create new obligations under the existing liability.

#### *Time Value of Money*

- A54. Entities are not indifferent to the timing of an outflow of resources. Accordingly, the timing of the future outflows of resources is a characteristic of a liability and needs to be encompassed in any measurement of a liability's current value. Failure to reflect the time value of money would mean that the resulting measurement would not be a faithful representation of the economic burden the liability represents.
- A55. An entity shall determine the estimated outflows of resources by adjusting the estimates of future outflows of resources for the time value of money, using discount rates that reflect the characteristics of the liability. Such rates shall:
- (a) Be consistent with observable current market prices for instruments with outflows of resources whose characteristics are consistent with those of the liability's outflows of resources, in terms of, for example, timing, currency and liquidity.
  - (b) Exclude the effect of any factors that influence the observable market prices but that are not relevant to the outflows of resources of the liability.

- A56. When using a risk-free rate, the logical sources of reference rates are high quality bonds, for example, bonds issued by a financially sound government. These instruments should include no or insignificant default risk. They will also typically have a range of maturity dates or durations to match the liability durations. In the event that long-dated bonds are unavailable for liabilities with long durations, such as some decommissioning liabilities, it would be necessary to use extrapolation techniques to estimate the rates.
- A57. Although rates on high quality government bonds will not need to be adjusted for default risk in determining the risk free discount rate, they may need to be adjusted for liquidity risk. Some government bonds are traded in deep and liquid markets enabling bond holders to readily sell them at minimal cost. The rate payable on such bonds is lower than the rate payable on an equivalent illiquid bond. Accordingly, it might be necessary to include a 'premium for illiquidity' in the observed rate for government bonds that are not traded in deep and liquid markets.

### **Inputs to Valuation Techniques**

#### *General Principles*

- A58. **Valuation techniques used in a cost of fulfillment measurement shall maximize the use of relevant observable inputs and minimize the use of unobservable inputs.**
- A59. The cost of fulfillment measurement is an entity specific valuation. When a valuation technique is applied, an entity shall select inputs that are consistent with the characteristics of the liability (see paragraph B14). The technique should maximize the use of observable inputs that are available to a market participant that is making the same valuation as the entity, from the entity's perspective. For example, when measuring the cost to fulfill a decommissioning liability where payments are due in 50 years, an observable market input when discounting the outflow of resources is the government bond rate applicable to the entity.
- A60. In some cases the characteristics of a liability may result in the application of an adjustment (e.g., there is no corresponding bond rate to discount an outflow of resources due in 3.5 years). However, a cost of fulfillment measurement shall not incorporate an adjustment that is inconsistent with the unit of account in the IPSAS that requires or permits the cost of fulfillment measurement.
- A61. When a liability will settle at a future date, the assumptions applied in developing and identifying inputs are based on current market conditions. For example, a decommissioning liability may be expected to settle in 50 years. The payment due on settlement and the associated discount rate are both based on information available at the measurement date.

**Appendix B: Fair value—application guidance**

*This Appendix is an integral part of [draft] IPSAS [X] (ED XX).*

**Measurement**

Paragraph B1 is IFRS 13.B2

- B1. The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. A fair value measurement requires an entity to determine all the following:
- (a) The particular asset or liability that is the subject of the measurement (consistently with its unit of account).
  - (b) For a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use).
  - (c) The principal (or most advantageous) market for the asset or liability.
  - (d) The valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorized.

**The Asset or Liability**

- B2. A fair value measurement is for a particular asset or liability. Therefore, when measuring fair value an entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Such characteristics include, for example, the following:
- (a) **The condition and location of the asset; and**
  - (b) **Restrictions, if any, on the sale or use of the asset.**
- B3. The effect on the measurement arising from a particular characteristic will differ depending on how that characteristic would be taken into account by market participants.
- B4. The asset or liability measured at fair value might be either of the following:
- (a) A stand-alone asset or liability (e.g., a financial instrument or a non-financial asset); or
  - (b) A group of assets, a group of liabilities or a group of assets and liabilities (e.g., a cash-generating unit or an operation).
- B5. Whether the asset or liability is a stand-alone asset or liability, a group of assets, a group of liabilities or a group of assets and liabilities for recognition or disclosure purposes depends on its *unit of account*. The unit of account for the asset or liability shall be determined in accordance with the IPSAS that requires or permits the fair value measurement, except as provided in this Application Guidance.

**The Transaction**

- B6. **A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions.**
- B7. **A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:**
- (a) In the principal market for the asset or liability; or**
  - (b) In the absence of a principal market, in the most advantageous market for the asset or liability.**
- B8. An entity need not undertake an exhaustive search of all possible markets to identify the principal market or, in the absence of a principal market, the most advantageous market, but it shall take into account all information that is reasonably available. In the absence of evidence to the contrary, the market in which the entity would normally enter into a transaction to sell the asset or to transfer the liability is presumed to be the principal market or, in the absence of a principal market, the most advantageous market.
- B9. If there is a principal market for the asset or liability, the fair value measurement shall represent the price in that market (whether that price is directly observable or estimated using another valuation technique), even if the price in a different market is potentially more advantageous at the measurement date.
- B10. The entity must have access to the principal (or most advantageous) market at the measurement date. Because different entities (and operations within those entities) with different activities may have access to different markets, the principal (or most advantageous) market for the same asset or liability might be different for different entities (and operations within those entities). Therefore, the principal (or most advantageous) market (and thus, market participants) shall be considered from the perspective of the entity, thereby allowing for differences between and among entities with different activities.
- B11. Although an entity must be able to access the market, the entity does not need to be able to sell the particular asset or transfer the particular liability on the measurement date to be able to measure fair value on the basis of the price in that market.
- B12. Even when there is no observable market to provide pricing information about the sale of an asset or the transfer of a liability at the measurement date, a fair value measurement shall assume that a transaction takes place at that date, considered from the perspective of a market participant that holds the asset or owes the liability. That assumed transaction establishes a basis for estimating the price to sell the asset or to transfer the liability.

**Market Participants**

- B13. **An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.**
- B14. In developing those assumptions, an entity need not identify specific market participants. Rather, the entity shall identify characteristics that distinguish market participants generally, considering factors specific to all the following:

- (a) The asset or liability;
- (b) The principal (or most advantageous) market for the asset or liability; and
- (c) Market participants with whom the entity would enter into a transaction in that market.

### The Price

- B15. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e., an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.**
- B16. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for *transaction costs*. Transaction costs shall be accounted for in accordance with other IPSASs. Transaction costs are not a characteristic of an asset or a liability; rather, they are specific to a transaction and will differ depending on how an entity enters into a transaction for the asset or liability.
- B17. Transaction costs do not include *transport costs*. If location is a characteristic of the asset (as might be the case, for example, for a commodity), the price in the principal (or most advantageous) market shall be adjusted for the costs, if any, that would be incurred to transport the asset from its current location to that market.

### Fair Value at Initial Recognition

- B18. When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an *entry price*). In contrast, the fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an exit price). Entities do not necessarily sell assets at the prices paid to acquire them. Similarly, entities do not necessarily transfer liabilities at the prices received to assume them.
- B19. In many cases the transaction price will equal the fair value (e.g., that might be the case when on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold).
- B20. When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. Paragraph B22 describes situations in which the transaction price might not represent the fair value of an asset or a liability at initial recognition.
- B21. If another IPSAS requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the entity shall recognize the resulting gain or loss in surplus or deficit unless that IPSAS specifies otherwise.

Paragraph B22 is IFRS 13.B4
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- B22. When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. For example, the transaction price might not represent the fair value of an asset or a liability at initial recognition if any of the following conditions exist:

- (a) The transaction is between related parties, although the price in a related party transaction may be used as an input into a fair value measurement if the entity has evidence that the transaction was entered into at market terms.
- (b) The transaction takes place under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.
- (c) The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value. For example, that might be the case if the asset or liability measured at fair value is only one of the elements in the transaction (e.g., in a public sector combination), the transaction includes unstated rights and privileges that are measured separately in accordance with another IPSAS, or the transaction price includes transaction costs.
- (d) The market in which the transaction takes place is different from the principal market (or most advantageous market). For example, those markets might be different if the entity is a dealer that enters into transactions with customers in the retail market, but the principal (or most advantageous) market for the exit transaction is with other dealers in the dealer market.

### **Valuation Techniques**

- B23. An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.**
- B24. The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. Three widely used valuation techniques are the market approach, the cost approach and the income approach. The main aspects of those approaches are summarized in paragraphs B29–B35. An entity shall use valuation techniques consistent with one or more of those approaches to measure fair value.
- B25. In some cases a single valuation technique will be appropriate (e.g., when valuing an asset or a liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate (e.g., that might be the case when valuing a cash-generating unit). If multiple valuation techniques are used to measure fair value, the results (i.e., respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.
- B26. If the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be calibrated so that at initial recognition the result of the valuation technique equals the transaction price. Calibration ensures that the valuation technique reflects current market conditions, and it helps an entity to determine whether an adjustment to the valuation technique is necessary (e.g., there might be a characteristic of the asset or liability that is not captured by the valuation technique). After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, an entity shall ensure that those valuation techniques reflect observable market data (e.g., the price for a similar asset or liability) at the measurement date.
- B27. Valuation techniques used to measure fair value shall be applied consistently. However, a change in a valuation technique or its application (e.g., a change in its weighting when multiple valuation

techniques are used or a change in an adjustment applied to a valuation technique) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. That might be the case if, for example, any of the following events take place:

- (a) New markets develop;
- (b) New information becomes available;
- (c) Information previously used is no longer available;
- (d) Valuation techniques improve; or
- (e) Market conditions change.

B28. Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate in accordance with IPSAS 3. However, the disclosures in IPSAS 3 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

#### *Market Approach*

Paragraphs B29-B31 are IFRS 13.B5-B7

B29. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (i.e., similar) assets, liabilities or a group of assets and liabilities, such as an operation.

B30. For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might be in ranges with a different multiple for each comparable. The selection of the appropriate multiple within the range requires judgement, considering qualitative and quantitative factors specific to the measurement.

B31. Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value some types of financial instruments, such as debt securities, without relying exclusively on quoted prices for the specific securities, but rather relying on the securities' relationship to other benchmark quoted securities.

#### *Cost Approach*

Paragraphs B32 and B33 are IFRS 13.B8 and B9

B32. The cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

B33. From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. That is because a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset. Obsolescence encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives). In many cases the current replacement cost method is used to measure the fair value of tangible assets that are used in combination with other assets or with other assets and liabilities.

*Income Approach*

Paragraphs B34 and B35 are IFRS 13.B10 and B11

B34. The income approach converts future amounts (e.g., cash flows or income and expenses) to a single current (i.e., discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts.

B35. Those valuation techniques include, for example, the following:

- (a) Present value techniques (see paragraphs B36–B55);
- (b) Option pricing models, such as the Black-Scholes-Merton formula or a binomial model (i.e., a lattice model), that incorporate present value techniques and reflect both the time value and the intrinsic value of an option; and
- (c) The multi-period excess earnings method, which is used to measure the fair value of some intangible assets.

*Present Value Techniques*

Paragraphs B36 and B37 are IFRS 13.B12 and B13

B36. Paragraphs 37–54 describe the use of present value techniques to measure fair value. Those paragraphs focus on a discount rate adjustment technique and an expected cash flow (expected present value) technique. Those paragraphs neither prescribe the use of a single specific present value technique nor limit the use of present value techniques to measure fair value to the techniques discussed. The present value technique used to measure fair value will depend on facts and circumstances specific to the asset or liability being measured (e.g., whether prices for comparable assets or liabilities can be observed in the market) and the availability of sufficient data.

*The Components of a Present Value Measurement*

B37. Present value (i.e., an application of the income approach) is a tool used to link future amounts (e.g., cash flows or values) to a present amount using a discount rate. A fair value measurement of an asset or a liability using a present value technique captures all the following elements from the perspective of market participants at the measurement date:

- (a) An estimate of future cash flows for the asset or liability being measured.
- (b) Expectations about possible variations in the amount and timing of the cash flows representing the uncertainty inherent in the cash flows.
- (c) The time value of money, represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default to the holder (i.e., a risk-free interest rate).
- (d) The price for bearing the uncertainty inherent in the cash flows (i.e., a risk premium).
- (e) Other factors that market participants would take into account in the circumstances.
- (f) For a liability, the non-performance risk relating to that liability, including the entity's (i.e., the obligor's) own credit risk.

*General Principles*

Paragraph B38 is IFRS 13.B14

B38. Present value techniques differ in how they capture the elements in paragraph B37. However, all the following general principles govern the application of any present value technique used to measure fair value:

- (a) Cash flows and discount rates should reflect assumptions that market participants would use when pricing the asset or liability.
- (b) Cash flows and discount rates should take into account only the factors attributable to the asset or liability being measured.
- (c) To avoid double-counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the cash flows. For example, a discount rate that reflects the uncertainty in expectations about future defaults is appropriate if using contractual cash flows of a loan (i.e., a discount rate adjustment technique). That same rate should not be used if using expected (i.e., probability-weighted) cash flows (i.e., an expected present value technique) because the expected cash flows already reflect assumptions about the uncertainty in future defaults; instead, a discount rate that is commensurate with the risk inherent in the expected cash flows should be used.
- (d) Assumptions about cash flows and discount rates should be internally consistent. For example, nominal cash flows, which include the effect of inflation, should be discounted at a rate that includes the effect of inflation. The nominal risk-free interest rate includes the effect of inflation. Real cash flows, which exclude the effect of inflation, should be discounted at a rate that excludes the effect of inflation. Similarly, after-tax cash flows should be discounted using an after-tax discount rate. Pre-tax cash flows should be discounted at a rate consistent with those cash flows.
- (e) Discount rates should be consistent with the underlying economic factors of the currency in which the cash flows are denominated.

*Risk and Uncertainty*

Paragraphs B39-B41 are IFRS 13.B15-B17

B39. A fair value measurement using present value techniques is made under conditions of uncertainty because the cash flows used are estimates rather than known amounts. In many cases both the amount and timing of the cash flows are uncertain. Even contractually fixed amounts, such as the payments on a loan, are uncertain if there is risk of default.

B40. Market participants generally seek compensation (i.e., a risk premium) for bearing the uncertainty inherent in the cash flows of an asset or a liability. A fair value measurement should include a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows. Otherwise, the measurement would not faithfully represent fair value. 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.

B41. Present value techniques differ in how they adjust for risk and in the type of cash flows they use. For example:

- (a) The discount rate adjustment technique (see paragraphs B42-B46) uses a risk-adjusted discount rate and contractual, promised or most likely cash flows.
- (b) Method 1 of the expected present value technique (see paragraph B49) uses risk-adjusted expected cash flows and a risk-free rate.
- (c) Method 2 of the expected present value technique (see paragraph B50) uses expected cash flows that are not risk-adjusted and a discount rate adjusted to include the risk premium that market participants require. That rate is different from the rate used in the discount rate adjustment technique.

#### *Discount Rate Adjustment Technique*

Paragraphs B42-B46 are IFRS 13.B18-B22
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- B42. The discount rate adjustment technique uses a single set of cash flows from the range of possible estimated amounts, whether contractual or promised (as is the case for a bond) or most likely cash flows. In all cases, those cash flows are conditional upon the occurrence of specified events (e.g., contractual or promised cash flows for a bond are conditional on the event of no default by the debtor). The discount rate used in the discount rate adjustment technique is derived from observed rates of return for comparable assets or liabilities that are traded in the market. Accordingly, the contractual, promised or most likely cash flows are discounted at an observed or estimated market rate for such conditional cash flows (i.e., a market rate of return).
- B43. The discount rate adjustment technique requires an analysis of market data for comparable assets or liabilities. Comparability is established by considering the nature of the cash flows (e.g., whether the cash flows are contractual or non-contractual and are likely to respond similarly to changes in economic conditions), as well as other factors (e.g., credit standing, collateral, duration, restrictive covenants and liquidity). Alternatively, if a single comparable asset or liability does not fairly reflect the risk inherent in the cash flows of the asset or liability being measured, it may be possible to derive a discount rate using data for several comparable assets or liabilities in conjunction with the risk-free yield curve (i.e., using a 'build-up' approach).
- B44. To illustrate a build-up approach, assume that Asset A is a contractual right to receive CU800 in one year (i.e., there is no timing uncertainty). There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:
- (a) Asset B is a contractual right to receive CU1,200 in one year and has a market price of CU1,083. Thus, the implied annual rate of return (i.e., a one-year market rate of return) is 10.8 per cent  $[(CU1,200/CU1,083) - 1]$ .
  - (b) Asset C is a contractual right to receive CU700 in two years and has a market price of CU566. Thus, the implied annual rate of return (i.e., a two-year market rate of return) is 11.2 per cent  $[(CU700/CU566)^{0.5} - 1]$ .
  - (c) All three assets are comparable with respect to risk (i.e., dispersion of possible pay-offs and credit).
- B45. On the basis of the timing of the contractual payments to be received for Asset A relative to the timing for Asset B and Asset C (i.e., one year for Asset B versus two years for Asset C), Asset B is deemed more comparable to Asset A. Using the contractual payment to be received for Asset A (CU800) and the one-year market rate derived from Asset B (10.8 per cent), the fair value of Asset A is CU722 (CU800/1.108). Alternatively, in the absence of available market information for Asset B, the one-

year market rate could be derived from Asset C using the build-up approach. In that case the two-year market rate indicated by Asset C (11.2 per cent) would be adjusted to a one-year market rate using the term structure of the risk-free yield curve. Additional information and analysis might be required to determine whether the risk premiums for one-year and two-year assets are the same. If it is determined that the risk premiums for one-year and two-year assets are not the same, the two-year market rate of return would be further adjusted for that effect.

- B46. When the discount rate adjustment technique is applied to fixed receipts or payments, the adjustment for risk inherent in the cash flows of the asset or liability being measured is included in the discount rate. In some applications of the discount rate adjustment technique to cash flows that are not fixed receipts or payments, an adjustment to the cash flows may be necessary to achieve comparability with the observed asset or liability from which the discount rate is derived.

#### *Expected Present Value Technique*

Paragraphs B47-B54 are IFRS 13.AG23-AG30

- B47. The expected present value technique uses as a starting point a set of cash flows that represents the probability-weighted average of all possible future cash flows (i.e., the expected cash flows). The resulting estimate is identical to expected value, which, in statistical terms, is the weighted average of a discrete random variable's possible values with the respective probabilities as the weights. Because all possible cash flows are probability-weighted, the resulting expected cash flow is not conditional upon the occurrence of any specified event (unlike the cash flows used in the discount rate adjustment technique).
- B48. In making an investment decision, risk-averse market participants would take into account the risk that the actual cash flows may differ from the expected cash flows. Portfolio theory distinguishes between two types of risk:
- Unsystematic (diversifiable) risk, which is the risk specific to a particular asset or liability.
  - Systematic (non-diversifiable) risk, which is the common risk shared by an asset or a liability with the other items in a diversified portfolio.

Portfolio theory holds that in a market in equilibrium, market participants will be compensated only for bearing the systematic risk inherent in the cash flows. (In markets that are inefficient or out of equilibrium, other forms of return or compensation might be available.)

- B49. Method 1 of the expected present value technique adjusts the expected cash flows of an asset for systematic (i.e., market) risk by subtracting a cash risk premium (i.e., risk-adjusted expected cash flows). Those risk-adjusted expected cash flows represent a certainty-equivalent cash flow, which is discounted at a risk-free interest rate. A certainty-equivalent cash flow refers to an expected cash flow (as defined), adjusted for risk so that a market participant is indifferent to trading a certain cash flow for an expected cash flow. For example, if a market participant was willing to trade an expected cash flow of CU1,200 for a certain cash flow of CU1,000, the CU1,000 is the certainty equivalent of the CU1,200 (i.e., the CU200 would represent the cash risk premium). In that case the market participant would be indifferent as to the asset held.
- B50. In contrast, Method 2 of the expected present value technique adjusts for systematic (i.e., market) risk by applying a risk premium to the risk-free interest rate. Accordingly, the expected cash flows are discounted at a rate that corresponds to an expected rate associated with probability-weighted cash flows (i.e., an expected rate of return). Models used for pricing risky assets, such as the capital asset

pricing model, can be used to estimate the expected rate of return. Because the discount rate used in the discount rate adjustment technique is a rate of return relating to conditional cash flows, it is likely to be higher than the discount rate used in Method 2 of the expected present value technique, which is an expected rate of return relating to expected or probability-weighted cash flows.

- B51. To illustrate Methods 1 and 2, assume that an asset has expected cash flows of CU780 in one year determined on the basis of the possible cash flows and probabilities shown below. The applicable risk-free interest rate for cash flows with a one-year horizon is 5 per cent, and the systematic risk premium for an asset with the same risk profile is 3 per cent.

Possible cash flows	Probability	Probability-weighted cash flows
CU500	15%	CU75
CU800	60%	CU480
CU900	25%	CU225
Expected cash flows		CU780

- B52. In this simple illustration, the expected cash flows (CU780) represent the probability-weighted average of the three possible outcomes. In more realistic situations, there could be many possible outcomes. However, to apply the expected present value technique, it is not always necessary to take into account distributions of all possible cash flows using complex models and techniques. Rather, it might be possible to develop a limited number of discrete scenarios and probabilities that capture the array of possible cash flows. For example, an entity might use realized cash flows for some relevant past period, adjusted for changes in circumstances occurring subsequently (e.g., changes in external factors, including economic or market conditions, industry trends and competition as well as changes in internal factors affecting the entity more specifically), taking into account the assumptions of market participants.
- B53. In theory, the present value (i.e., the fair value) of the asset's cash flows is the same whether determined using Method 1 or Method 2, as follows:
- Using Method 1, the expected cash flows are adjusted for systematic (i.e., market) risk. In the absence of market data directly indicating the amount of the risk adjustment, such adjustment could be derived from an asset pricing model using the concept of certainty equivalents. For example, the risk adjustment (i.e., the cash risk premium of CU22) could be determined using the systematic risk premium of 3 per cent ( $CU780 - [CU780 \times (1.05/1.08)]$ ), which results in risk-adjusted expected cash flows of CU758 ( $CU780 - CU22$ ). The CU758 is the certainty equivalent of CU780 and is discounted at the risk-free interest rate (5 per cent). The present value (i.e., the fair value) of the asset is CU722 ( $CU758/1.05$ ).
  - Using Method 2, the expected cash flows are not adjusted for systematic (i.e., market) risk. Rather, the adjustment for that risk is included in the discount rate. Thus, the expected cash flows are discounted at an expected rate of return of 8 per cent (i.e., the 5 per cent risk-free interest rate plus the 3 per cent systematic risk premium). The present value (i.e., the fair value) of the asset is CU722 ( $CU780/1.08$ ).

- B54. When using an expected present value technique to measure fair value, either Method 1 or Method 2 could be used. The selection of Method 1 or Method 2 will depend on facts and circumstances specific to the asset or liability being measured, the extent to which sufficient data are available and the judgements applied.

### **Inputs to Valuation Techniques**

#### *General Principles*

- B55. Valuation techniques used to measure fair value shall maximize the use of relevant observable inputs and minimize the use of unobservable inputs.**

- B56. Examples of markets in which inputs might be observable for some assets and liabilities (e.g., financial instruments) include exchange markets, dealer markets, brokered markets and principal-to-principal markets (see paragraph B57).

Paragraph B57 is IFRS 13.B34
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- B57. Examples of markets in which inputs might be observable for some assets and liabilities (e.g., financial instruments) include the following:

- (a) Exchange markets. In an exchange market, closing prices are both readily available and generally representative of fair value. An example of such a market is the London Stock Exchange.
- (b) Dealer markets. In a dealer market, dealers stand ready to trade (either buy or sell for their own account), thereby providing liquidity by using their capital to hold an inventory of the items for which they make a market. Typically bid and ask prices (representing the price at which the dealer is willing to buy and the price at which the dealer is willing to sell, respectively) are more readily available than closing prices. Over-the-counter markets (for which prices are publicly reported) are dealer markets. Dealer markets also exist for some other assets and liabilities, including some financial instruments, commodities and physical assets (e.g., used equipment).
- (c) Brokered markets. In a brokered market, brokers attempt to match buyers with sellers but do not stand ready to trade for their own account. In other words, brokers do not use their own capital to hold an inventory of the items for which they make a market. The broker knows the prices bid and asked by the respective parties, but each party is typically unaware of another party's price requirements. Prices of completed transactions are sometimes available. Brokered markets include electronic communication networks, in which buy and sell orders are matched, and commercial and residential real estate markets.
- (d) Principal-to-principal markets. In a principal-to-principal market, transactions, both originations and resales, are negotiated independently with no intermediary. Little information about those transactions may be made available publicly.

- B58. An entity shall select inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability (see paragraphs B2 and B3). In some cases those characteristics result in the application of an adjustment, such as a premium or discount (e.g., a control premium or non-controlling interest discount). However, a fair value measurement shall not incorporate a premium or discount that is inconsistent with the unit of account in the IPSAS that requires or permits the fair value measurement

(see paragraphs B4 and B5). Premiums or discounts that reflect size as a characteristic of the entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity, as described in paragraph B67) rather than as a characteristic of the asset or liability (e.g., a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement. In all cases, if there is a quoted price in an active market (i.e., a Level 1 input) for an asset or a liability, an entity shall use that price without adjustment when measuring fair value, except as specified in paragraph B66.

### **Fair Value Hierarchy**

- B59. To increase consistency and comparability in fair value measurements and related disclosures, this Application Guidance establishes a fair value hierarchy that categorizes into three levels (see paragraphs B63–B90) the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).
- B60. In some cases, the inputs used to measure the fair value of an asset or a liability might be categorized within different levels of the fair value hierarchy. In those cases, the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement. Assessing the significance of a particular input to the entire measurement requires judgement, taking into account factors specific to the asset or liability. Adjustments to arrive at measurements based on fair value, such as costs to sell when measuring fair value less costs to sell, shall not be taken into account when determining the level of the fair value hierarchy within which a fair value measurement is categorized.
- B61. The availability of relevant inputs and their relative subjectivity might affect the selection of appropriate valuation techniques (see paragraph B23). However, the fair value hierarchy prioritizes the inputs to valuation techniques, not the valuation techniques used to measure fair value. For example, a fair value measurement developed using a present value technique might be categorized within Level 2 or Level 3, depending on the inputs that are significant to the entire measurement and the level of the fair value hierarchy within which those inputs are categorized.
- B62. If an observable input requires an adjustment using an unobservable input and that adjustment results in a significantly higher or lower fair value measurement, the resulting measurement would be categorized within Level 3 of the fair value hierarchy. For example, if a market participant would take into account the effect of a restriction on the sale of an asset when estimating the price for the asset, an entity would adjust the quoted price to reflect the effect of that restriction. If that quoted price is a Level 2 input and the adjustment is an unobservable input that is significant to the entire measurement, the measurement would be categorized within Level 3 of the fair value hierarchy.

#### *Level 1 Inputs*

- B63. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
- B64. A quoted price in an active market provides the most faithfully representative evidence of fair value and shall be used without adjustment to measure fair value whenever available, except as specified in paragraph B66.

- B65. A Level 1 input will be available for many financial assets and financial liabilities, some of which might be exchanged in multiple active markets (e.g., on different exchanges). Therefore, the emphasis within Level 1 is on determining both of the following:
- (a) The principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability; and
  - (b) Whether the entity can enter into a transaction for the asset or liability at the price in that market at the measurement date.
- B66. An entity shall not make an adjustment to a Level 1 input except in the following circumstances:
- (a) When an entity holds a large number of similar (but not identical) assets or liabilities (e.g., debt securities) that are measured at fair value and a quoted price in an active market is available but not readily accessible for each of those assets or liabilities individually (i.e., given the large number of similar assets or liabilities held by the entity, it would be difficult to obtain pricing information for each individual asset or liability at the measurement date). In that case, as a practical expedient, an entity may measure fair value using an alternative pricing method that does not rely exclusively on quoted prices (e.g., matrix pricing). However, the use of an alternative pricing method results in a fair value measurement categorized within a lower level of the fair value hierarchy.
  - (b) When a quoted price in an active market does not represent fair value at the measurement date. That might be the case if, for example, significant events (such as transactions in a principal-to-principal market, trades in a brokered market or announcements) take place after the close of a market but before the measurement date. An entity shall establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment results in a fair value measurement categorized within a lower level of the fair value hierarchy.
  - (c) When measuring the fair value of a liability or an entity's own equity instrument using the quoted price for the identical item traded as an asset in an active market and that price needs to be adjusted for factors specific to the item or the asset (see paragraph xx of IPSAS 41). If no adjustment to the quoted price of the asset is required, the result is a fair value measurement categorized within Level 1 of the fair value hierarchy. However, any adjustment to the quoted price of the asset results in a fair value measurement categorized within a lower level of the fair value hierarchy.
- B67. If an entity holds a position in a single asset or liability (including a position comprising a large number of identical assets or liabilities, such as a holding of financial instruments) and the asset or liability is traded in an active market, the fair value of the asset or liability shall be measured within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held by the entity. That is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

### *Level 2 Inputs*

- B68. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- B69. If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

- (a) Quoted prices for similar assets or liabilities in active markets.
- (b) Quoted prices for identical or similar assets or liabilities in markets that are not active.
- (c) inputs other than quoted prices that are observable for the asset or liability, for example:
  - (i) Interest rates and yield curves observable at commonly quoted intervals;
  - (ii) Implied volatilities; and
  - (iii) Credit spreads.
- (d) Market-corroborated inputs.

B70. Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the following:

- (a) The condition or location of the asset;
- (b) The extent to which inputs relate to items that are comparable to the asset or liability (including those factors described in paragraph xx of IPSAS 41; and
- (c) The volume or level of activity in the markets within which the inputs are observed.

B71. An adjustment to a Level 2 input that is significant to the entire measurement might result in a fair value measurement categorized within Level 3 of the fair value hierarchy if the adjustment uses significant unobservable inputs.

B72. Paragraph B73 describes the use of Level 2 inputs for particular assets and liabilities.

Paragraph B73 is IFRS 13.B35
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B73. Examples of Level 2 inputs for particular assets and liabilities include the following:

- (a) Licensing arrangement. For a licensing arrangement that is acquired in a public sector combination and was recently negotiated with an unrelated party by the acquired entity (the party to the licensing arrangement), a Level 2 input would be the royalty rate in the contract with the unrelated party at inception of the arrangement.
- (b) Finished goods inventory at a retail outlet. For finished goods inventory that is acquired in a public sector combination, a Level 2 input would be either a price to customers in a retail market or a price to retailers in a wholesale market, adjusted for differences between the condition and location of the inventory item and the comparable (i.e., similar) inventory items so that the fair value measurement reflects the price that would be received in a transaction to sell the inventory to another retailer that would complete the requisite selling efforts. Conceptually, the fair value measurement will be the same, whether adjustments are made to a retail price (downward) or to a wholesale price (upward). Generally, the price that requires the least amount of subjective adjustments should be used for the fair value measurement.
- (c) Building held and used. A Level 2 input would be the price per square meter for the building (a valuation multiple) derived from observable market data, e.g., multiples derived from prices in observed transactions involving comparable (i.e., similar) buildings in similar locations.
- (d) Cash-generating unit. A Level 2 input would be a valuation multiple (e.g., a multiple of earnings or revenue or a similar performance measure) derived from observable market data, e.g., multiples derived from prices in observed transactions involving comparable (i.e., similar) operations, taking into account operational, market, financial and non-financial factors.

*Level 3 Inputs*

- B74. Level 3 inputs are unobservable inputs for the asset or liability.
- B75. Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, i.e., an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.
- B76. Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique. A measurement that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one when pricing the asset or liability. For example, it might be necessary to include a risk adjustment when there is significant measurement uncertainty (e.g., when there has been a significant decrease in the volume or level of activity when compared with normal market activity for the asset or liability, or similar assets or liabilities, and the entity has determined that the transaction price or quoted price does not represent fair value, as described in paragraphs B77–B87).

*Measuring fair value when the volume or level of activity for an asset or a liability has significantly decreased*

Paragraphs B77–B87 are IFRS 13.B37-B47
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- B77. The fair value of an asset or a liability might be affected when there has been a significant decrease in the volume or level of activity for that asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). To determine whether, on the basis of the evidence available, there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate the significance and relevance of factors such as the following:
- (a) There are few recent transactions.
  - (b) Price quotations are not developed using current information.
  - (c) Price quotations vary substantially either over time or among market-makers (e.g., some brokered markets).
  - (d) Indices that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.
  - (e) There is a significant increase in implied liquidity risk premiums, yields or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the entity's estimate of expected cash flows, taking into account all available market data about credit and other non-performance risk for the asset or liability.
  - (f) There is a wide bid-ask spread or significant increase in the bid-ask spread.
  - (g) There is a significant decline in the activity of, or there is an absence of, a market for new issues (i.e., a primary market) for the asset or liability or similar assets or liabilities.
  - (h) Little information is publicly available (e.g., for transactions that take place in a principal-to-principal market).

- B78. If an entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed. A decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly. However, if an entity determines that a transaction or quoted price does not represent fair value (e.g., there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary if the entity uses those prices as a basis for measuring fair value and that adjustment may be significant to the fair value measurement in its entirety. Adjustments also may be necessary in other circumstances (e.g., when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured or when the price is stale).
- B79. This Application Guidance does not prescribe a methodology for making significant adjustments to transactions or quoted prices. See paragraphs B23–B28 and B29–B35 for a discussion of the use of valuation techniques when measuring fair value. Regardless of the valuation technique used, an entity shall include appropriate risk adjustments, including a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows of an asset or a liability (see paragraph B41). Otherwise, the measurement does not faithfully represent fair value. In some cases determining the appropriate risk adjustment might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. The risk adjustment shall be reflective of an orderly transaction between market participants at the measurement date under current market conditions.
- B80. If there has been a significant decrease in the volume or level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (e.g., the use of a market approach and a present value technique). When weighting indications of fair value resulting from the use of multiple valuation techniques, an entity shall consider the reasonableness of the range of fair value measurements. The objective is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value measurements may be an indication that further analysis is needed.
- B81. Even when there has been a significant decrease in the volume or level of activity for the asset or liability, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (i.e., not a forced liquidation or distress sale) between market participants at the measurement date under current market conditions.
- B82. Estimating the price at which market participants would be willing to enter into a transaction at the measurement date under current market conditions if there has been a significant decrease in the volume or level of activity for the asset or liability depends on the facts and circumstances at the measurement date and requires judgement. 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.

#### *Identifying Transactions that are not Orderly*

- B83. The determination of whether a transaction is orderly (or is not orderly) is more difficult if there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). In such circumstances it is not appropriate to conclude that all transactions in that market are not orderly (i.e., forced

liquidations or distress sales). Circumstances that may indicate that a transaction is not orderly include the following:

- (a) There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions.
- (b) There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.
- (c) The seller is in or near bankruptcy or receivership (i.e., the seller is distressed).
- (d) The seller was required to sell to meet regulatory or legal requirements (i.e., the seller was forced).
- (e) The transaction price is an outlier when compared with other recent transactions for the same or a similar asset or liability.

An entity shall evaluate the circumstances to determine whether, on the weight of the evidence available, the transaction is orderly.

B84. An entity shall consider all the following when measuring fair value or estimating market risk premiums:

- (a) If the evidence indicates that a transaction is not orderly, an entity shall place little, if any, weight (compared with other indications of fair value) on that transaction price.
- (b) If the evidence indicates that a transaction is orderly, an entity shall take into account that transaction price. The amount of weight placed on that transaction price when compared with other indications of fair value will depend on the facts and circumstances, such as the following:
  - (i) The volume of the transaction.
  - (ii) The comparability of the transaction to the asset or liability being measured.
  - (iii) The proximity of the transaction to the measurement date.
- (c) If an entity does not have sufficient information to conclude whether a transaction is orderly, it shall take into account the transaction price. However, that transaction price may not represent fair value (i.e., the transaction price is not necessarily the sole or primary basis for measuring fair value or estimating market risk premiums). When an entity does not have sufficient information to conclude whether particular transactions are orderly, the entity shall place less weight on those transactions when compared with other transactions that are known to be orderly.

An entity need not undertake exhaustive efforts to determine whether a transaction is orderly, but it shall not ignore information that is reasonably available. When an entity is a party to a transaction, it is presumed to have sufficient information to conclude whether the transaction is orderly.

#### *Using Quoted Prices Provided by Third Parties*

B85. This Application Guidance does not preclude the use of quoted prices provided by third parties, such as pricing services or brokers, if an entity has determined that the quoted prices provided by those parties are developed in accordance with this Application Guidance.

- B86. If there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate whether the quoted prices provided by third parties are developed using current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions (including assumptions about risk). In weighting a quoted price as an input to a fair value measurement, an entity places less weight (when compared with other indications of fair value that reflect the results of transactions) on quotes that do not reflect the result of transactions.
- B87. Furthermore, the nature of a quote (e.g., whether the quote is an indicative price or a binding offer) shall be taken into account when weighting the available evidence, with more weight given to quotes provided by third parties that represent binding offers.
- B88. An entity shall develop unobservable inputs using the best information available in the circumstances, which might include the entity's own data. In developing unobservable inputs, an entity may begin with its own data, but it shall adjust those data if reasonably available information indicates that other market participants would use different data or there is something particular to the entity that is not available to other market participants (e.g., an entity-specific synergy). An entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, an entity shall take into account all information about market participant assumptions that is reasonably available. Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement.
- B89. Paragraph B90 describes the use of Level 3 inputs for particular assets and liabilities.

Paragraph B90 is IFRS 13.B36
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- B90. Examples of Level 3 inputs for particular assets and liabilities include the following:
- (a) Long-dated currency swap. A Level 3 input would be an interest rate in a specified currency that is not observable and cannot be corroborated by observable market data at commonly quoted intervals or otherwise for substantially the full term of the currency swap. The interest rates in a currency swap are the swap rates calculated from the respective countries' yield curves.
  - (b) Three-year option on exchange-traded shares. A Level 3 input would be historical volatility, i.e., the volatility for the shares derived from the shares' historical prices. Historical volatility typically does not represent current market participants' expectations about future volatility, even if it is the only information available to price an option.
  - (c) Interest rate swap. A Level 3 input would be an adjustment to a mid-market consensus (non-binding) price for the swap developed using data that are not directly observable and cannot otherwise be corroborated by observable market data.
  - (d) Decommissioning liability assumed in a public sector combination. A Level 3 input would be a current estimate using the entity's own data about the future cash outflows to be paid to fulfil the obligation (including market participants' expectations about the costs of fulfilling the obligation and the compensation that a market participant would require for taking on the obligation to dismantle the asset) if there is no reasonably available information that indicates that market participants would use different assumptions. That Level 3 input would be used in a present value technique together with other inputs, e.g., a current risk-free interest rate or a credit-adjusted risk-free rate if the effect of the entity's credit standing on the fair value of the liability is reflected in the discount rate rather than in the estimate of future cash outflows.

- (e) Cash-generating unit. A Level 3 input would be a financial forecast (e.g., of cash) developed using the entity's own data if there is no reasonably available information that indicates that market participants would use different assumptions.

## Appendix C: Historical cost—application guidance for assets<sup>1</sup>

*This Appendix is an integral part of [draft] IPSAS [X] (ED XX).*

### Measurement

#### Historical Cost and Consideration

Paragraph C1 is based on the IPSASB's Conceptual Framework 7.13

- C1. Historical cost is the consideration given to acquire or develop an asset, which is the cash or cash equivalents or the value of the other consideration given, at the time of its acquisition or development. The objective of an historical cost measurement of an asset is to identify the consideration given to acquire and/or develop the asset.
- C2. An historical cost measurement requires an entity to determine all the following:
- (a) The particular asset that is the subject of the measurement (consistently with its unit of account).
  - (b) The consideration the entity gave to acquire and/or develop the asset. in terms of:
    - (i) Cash;
    - (ii) Cash equivalents; and
    - (iii) The value of other consideration.
  - (c) Factors used to identify what consideration should be included in (or excluded from) the asset's historical cost, including (for example) costs that are directly attributable to its acquisition and/or development and should be included (or not directly attributable and should be excluded).

#### *Deferred Payment–Cash Price Equivalent*

Paragraph C3 is based on IPSAS 16.31

- C3. If payment for an asset is deferred, then the consideration to include in its historical cost is the cash price equivalent of the payment. The difference between this amount and the total payments is recognized as interest expense over the period of credit.

#### *The Value of Other Consideration: Exchange for Non-Monetary Asset(s)*

Paragraph C4 is based on IPSAS 17.38

- C4. The consideration for an asset acquired in exchange for a nonmonetary asset or assets, or a combination of monetary and non-monetary assets, is the appropriate current value of the asset(s)

<sup>1</sup> *For Basis for Conclusions:* 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 IPSASs, rather than IPSAS, *Measurement*.

given up<sup>2</sup>, unless (a) the transaction is non-exchange or otherwise lacks commercial substance or (b) the current value of the asset given up cannot be measured to achieve the qualitative characteristics, taking into account the constraints. In those circumstances, the consideration for the acquired asset is the carrying amount of the asset given up.

### **The Asset Measured at Historical Cost**

- C5. The asset measured at historical cost might be one of the following:
- (a) A stand-alone asset; or
  - (b) A group of assets:
  - (c) Assets that form part of a group of assets and liabilities (e.g., a cash-generating unit or an operation).
- C6. Whether the asset is a stand-alone asset, a group of assets, or assets that form part of a group of assets and liabilities for recognition or disclosure purposes depends on its *unit of account*. The unit of account for the asset shall be determined in accordance with the IPSAS that requires or permits the historical cost measurement.

### **Historical Cost is Entity Specific and Asset specific**

- C7. Historical cost is an entity-specific measurement basis. Identification of the consideration given to acquire and/or develop the asset requires an understanding of the entity-specific:
- (a) Processes to acquire and/or develop the asset; and
  - (b) Procedures and timing for asset use (i.e. its use to provide services and/or generate cash flows).
- C8. The entity's (a) acquisition and development processes and (b) asset usage timing and procedures are also asset-specific, so that an historical cost measurement depends on collecting information about how the entity acquired and/or developed the particular asset that and is either readying for use or has put into use.

### **The Asset's Acquisition and/or Development**

- C9. When measuring historical cost an entity shall identify the consideration applicable to the asset's acquisition and/or development, by taking into account:**
- (a) The entity's process to acquire and/or develop the asset;**
  - (b) The period during which the entity incurred acquisition costs and/or development costs for the asset; and**
  - (c) When the entity began to use the asset to provide services and/or generate future economic benefits.**

#### *Process to Acquire, Construct, and/or Develop an Asset*

- C10. The process to acquire an asset may be relatively simple (e.g. purchase of a car or a bond) or complex (e.g. development of new software or construction of a subway line).

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<sup>2</sup> Refer to the consultation paper's flow chart as guidance for choice of an appropriate current value. IPSAS 16 and 17 presently require that the cost of such an asset is measured at fair value, using the "old" definition of fair value, which is equivalent to the Conceptual Framework's definition of market value, and allows for either an entry value or an exit value.

C11. The purchase of an asset may be followed by further expenditures to adapt the asset for the entity's own use and, until the asset is able to be used by the entity for its intended purpose, expenditures necessary to bring the asset into use will be included in the consideration identified as part of the asset's historical cost.

*Acquisition of an Asset through Purchase: The Consideration Given*

Paragraph C12 is based on IPSAS 16.28

**C12. The consideration of a purchased asset is the price paid to acquire the asset and any directly attributable expenditure. Directly attributable expenditure includes:**

- (a) **Transaction costs arising when acquiring an asset;**
- (b) **Transport costs incurred to transport the asset from the location where it was purchased to the place where it is used by the entity; and**
- (c) **Expenditures necessary to adapt the asset for the entity's own use.**

Paragraph C13 is based on the IASB's Conceptual Framework BC6.32 and BC6.33

C13. Transaction costs incurred in acquiring an asset are a feature of the transaction in which the asset was acquired. The historical cost of the asset reflects those transaction costs as the entity could not have acquire the asset without incurring those costs. Transaction costs that could be incurred in selling or disposing of the asset are feature of a possible future transaction. Historical cost do not include these possible transaction costs because, as an entry value, historical cost reflects the costs of acquiring the asset.

*Construction and Development of an Asset: The Consideration Given*

**C14. The consideration of an asset that the entity has constructed or developed itself comprises:**

- (a) **The consideration of purchased assets used in the construction or development of the asset; and**
- (b) **Other consideration directly attributable to the asset's construction or development.**

*Purchase, Construction and Development of an Asset: Examples of Consideration to Include*

Paragraph C15 is based on IPSAS 17.30 and IPSAS 17.31

**C15. Consideration includes costs that are directly attributable to the asset's acquisition and/or development, and these should be included in the asset's historical cost. Examples include:**

- (a) The asset's purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- (b) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Examples of such costs include:
  - (i) Costs of employee benefits (as defined in IPSAS 25, *Employee Benefits*) arising directly from the construction or acquisition of the asset;
  - (ii) Costs of site preparation;
  - (iii) Initial delivery and handling costs;

- (iv) Installation and assembly costs;
  - (v) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and
  - (vi) Professional fees arising directly from bringing the asset to its working condition.
- (c) Estimated costs to discharge an entity's obligations to dispose of the asset or restore the location/situation prior to acquiring and/or developing the asset, where those obligations are incurred either when the item is acquired, or as a consequence of having used the item during the asset acquisition and/or development period.

*Purchase, Construction and Development of an Asset: Examples of Consideration to Exclude*

C16. Costs related to an asset's acquisition and/or development are excluded from the consideration that forms part of an asset's historical cost, if they either:

- (a) Are not directly attributable to the asset's acquisition and/or development; or
- (b) Do not contribute to the asset's service potential and/or ability to generate future economic benefits.

Paragraph C17 is based on IPSAS 12.25 and IPSAS 17.36

C17. Examples of such costs include:

- (a) Administration and other general overhead costs.
- (b) Start-up costs that are not necessary to bring the asset to the condition necessary for it to be capable of operating in the manner intended by management. For example,
  - (i) Costs of opening a new facility or introducing a new product or service (including costs of advertising and promotional activities); and
  - (ii) Costs of conducting business in a new location or with a new class of customers (including costs of staff training).
- (c) Costs of operations that are unnecessary and incidental to the asset, even though the costs may occur before or during the asset's acquisition, construction or development activities. For example, a building site may be operated as a car park until construction starts. The car park operations are not necessary to construction of the building (i.e. bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management), and the related revenue and expenses are recognized in surplus or deficit, rather than included in the building's historical cost.
- (d) Operating losses incurred before the asset achieves its intended level of use; or
- (e) Abnormal amounts of wasted material, labor or other resources incurred in constructing or developing the asset.

Excluded: Costs Incurred Prior to Recognition of an Asset

C18. Costs are excluded from an asset's historical cost where those costs occur before the point at which another IPSAS allows that an asset should be recognized. For example, IPSAS 31, *Intangible Assets*, specifies that expenditure incurred before the date when an internally generated intangible asset first

meets the recognition criteria in IPSAS 31, *Intangible Assets*, shall be expensed. IPSAS 31 prohibits reinstatement of expenditure previously recognized as an expense.

Excluded: Costs Incurred After the Acquisition and/or Development of the Asset

Paragraph C19 is based on IPSAS 31.37

C19. Once the entity has acquired and/or completed the adaption or development of an asset, further costs are not included in the asset's historical cost. For example, once an asset is in the location and condition necessary for it to be capable of being used in the manner intended by management further costs are excluded from the asset's historical cost. Examples of costs to exclude include:

- (a) Costs incurred while an asset is capable of operating in the manner intended by management and has not yet been brought into use or is operated at less than full capacity;
- (b) Initial operating losses, such as those incurred while demand for the asset's output builds up; and
- (c) Costs of relocating or reorganizing part or all of the entity's operations.

#### **Amortized Cost**

Paragraph C20 is based on the IASB's Conceptual Framework 6.9

C20. The historical cost measurement basis is applied to financial instruments by measuring the instruments at amortized cost. Amortized cost reflects estimates of future cash flows, discounted at a rate determined at initial recognition. The amortized cost of a financial asset or financial liability is updated over time to depict subsequent changes, such as the accrual of interest, the impairment of a financial asset or payments.

C21. For variable rate instruments, where the asset or liability bears interest at a variable rate, the discount rate is updated to reflect changes in the variable rate.

**Appendix D: Replacement cost–application guidance**

*This Appendix is an integral part of [draft] IPSAS [X] (ED XX).*

**Measurement**

- D1. The objective of replacement cost measurement is to estimate 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. Replacement cost measurement requires an entity to determine all of the following:
- (a) The particular asset that needs to be measured.
  - (b) The most economic manner to replace the service potential of the asset.
  - (c) The appropriate valuation technique(s), considering the availability of data with which to develop inputs that represent the economic position of the entity.

**The Asset**

- D2. A replacement cost measurement is for a particular asset. Therefore, when measuring the replacement cost, an entity takes into account the characteristics of the particular asset relevant in determining the replacement cost at the measurement date.

*Characteristics of the Asset*

- D3. It is often difficult to separate the factors impacting the replacement cost of an asset into characteristics of the asset itself and the asset's intended use, which relate more to the asset's service potential (see paragraph D11). The following characteristics of an asset will often impact the determination of its replacement cost regardless of the asset's intended use:
- (a) The location of the asset; and
  - (b) The condition of the asset

*The Location of the Asset*

- D4. There may be circumstances where it is appropriate to value a property based on an alternative 'highest and best' use, regardless of its current or originally intended use. For example, this is often the case for the land under buildings which are no longer required in the locality.
- D5. However, a jurisdiction will usually deliver services to its citizens from an appropriate location. For example, schools and hospitals will ideally be located within the communities they serve; and local authority offices will be easily accessible to all citizens. The land on which these schools, hospitals or offices are built might be in expensive inner-city sites or in town and city centers rather than on cheaper land further away from the communities they serve. In these circumstances, the entity should consider these social policy reasons for particular locations, which will often not reflect its 'highest and best' use, and value the replacement cost of the land accordingly.

*The Condition of the Asset*

- D6. The replacement cost presented in the Statement of Financial Position and Notes to the Financial Statements should reflect the cost of replacing the service capacity of the asset at the reporting date. Thus the current gross replacement cost of a modern equivalent asset is adjusted by making deductions for physical obsolescence, functional obsolescence, and economic obsolescence (see

paragraphs D30 to D32), which are also used to assist in determining the useful economic life of the asset.

### *Componentization*

- D7. An entity is required to allocate the amount initially recognized in respect of an item of property, plant, and equipment to its significant parts and depreciate separately each such part. For example, an office building might comprise its external structure (foundations, walls, floors and roof—all of which have different design lives); its internal fit-out (offices, reception area, kitchen and canteen—which might have different lives; and plant (elevators, for example). The replacement cost of the building as a whole will normally have a separate useful life and replacement cost when compared to each component. The assessment of the remaining life of the external structure and the plant may be based on a consideration of the physical obsolescence as noted in paragraph D30.
- D8. It is therefore important that the entity identifies the 'significant parts' or components before the assessment of the replacement cost of the service capacity of the asset can begin. This is because the extent of componentization adopted by the entity could affect the scope of work in terms of the information collected during the assessment. In identifying components, an entity should have regard to the materiality of the asset(s) in relation to the Statement of Financial Position and also think carefully about what is 'significant' so as not to make the accounting process overly burdensome but at the same to ensure that the information presented in the financial statements is of relevance to users.

Paragraph D9 is based on IPSAS 17.61

- D9. There may be circumstances where an asset does not have any individually significant components, or the components of the asset all have similar useful lives and depreciation methods. Such components may be grouped in determining the replacement cost (and subsequent depreciation charge) of the asset as a whole.
- D10. Similarly, groups of assets which all have a similar useful life and depreciation method may be grouped in determining the replacement cost and subsequent depreciation charge for the entire group of assets. Such circumstances may exist where multiple assets are interdependent and have similar useful lives. For example, different types of infrastructure, including dams, waterways, clean water supply, and grey and dirt water treatment facilities; roads and road-related structures; rail networks; as well as electricity and gas supply networks may have assets that are all depreciated over similar time periods and on the same basis. However, in other cases, even though these assets work together to perform a single related function, each asset within the group may consist of significant components with different useful lives and replacement costs, so an entity will need to apply judgement to determine the appropriate level of componentization.

### **The Service Potential of the Asset**

NOTE: Paragraphs D11 and D12 are based on 7.41 of the conceptual framework.

- D11. **The appropriate service potential is that which the entity is capable of using or expects to use, having regard to the need to hold sufficient service capacity to deal with contingencies. Therefore, the replacement cost of an asset reflects expected changes in required service capacity.**
- D12. For example, if an entity owns a school that accommodates 500 pupils but, because of demographic changes since its construction, a school for 100 pupils would be adequate for the current and

reasonably foreseeable requirements, the replacement cost of the asset is that of a school for 100 pupils.

**D13. When estimating the service potential of an asset, an entity shall take into account the characteristics of the asset, which include:**

- (a) The intended use of the asset;**
- (b) The specifications of the asset; and**
- (c) Restrictions, if any, on the sale or use of the asset.**

*The Intended Use of the Asset*

D14. In carrying out an assessment of the replacement cost of land and built property, it is the use to which the asset has been put that will be the basis of the calculation of the replacement cost. For example, the replacement cost of an aircraft hangar that is being used as a storage warehouse will be that of a warehouse. Another example might be where city center land has been designated by the local authority as parkland.

*The Specifications of the Asset*

D15. There are several examples in the public sector of assets whose specifications are such that there are few (if any) similar assets whose replacement cost can be assessed in an active and liquid market.

**Buildings of Conventional Appearance that have Specialized Features**

D16. Some buildings have a conventional basic design that is superficially similar to other buildings that are regularly bought and sold in the market, but on closer inspection have specialized features designed to meet the requirements of the actual occupier. A typical example is a purpose-built embassy, which, although built to perform an office function, is situated on a site that includes extra stand-off land and includes designed-in security features such as thickened walls and toughened glazing. This type of building will often cost considerably more to develop and build than a normal office building, but provide extra service potential (in the form of security for its occupants) which cannot be replicated through the purchase of a normal office building. In this instance, provided that the occupying entity continues to require the extra service potential, the building should be treated as specialized and its replacement cost should take into account the extra cost of the specialized internal features and requirement for stand-off land.

**Buildings that Include Specialized Adaptations**

D17. As another example, some buildings will comprise conventional structures that have been adapted to the requirement of the occupier. For example, a commercial office building may have been purchased by a government department and adapted by provision of enhanced security features such as perimeter barriers or toughened glazing. An entity might opt to treat the cost of such specialized adaptations as a separate item in its financial statements<sup>3</sup>; in these cases, the entity will value the conventional building. Where the entity has not accounted for the costs of adaptation separately, the entity will need to consider whether the adaptations would impact the building's replacement cost.

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<sup>3</sup> As a guide, whilst specialized features designed-in to purpose-built buildings should normally be accounted for as part of the whole building, adaptations to existing buildings should normally be accounted for separately.

D18. Where an entity opts to include the adaptation costs within the property interest, the entity will need to ensure that those performing the valuation understand the general nature of the adaptations. It will not be appropriate, for example, for an entity to value an embassy's additional stand-off land (see paragraph D17) as surplus land: it is a necessary part of the property. Nor will it be appropriate for an entity to value a newly built embassy building as a conventional office block.

#### Historic Buildings

D19. It is rarely appropriate to value historic buildings on the basis of costing a modern reproduction by use of an identical replacement or modified reconstruction approach. Where an entity is considering doing so, it must be able to demonstrate that it is not valuing a mere facsimile of the existing asset and that the historic property itself is intrinsically part of the service potential.

D20. Where the historic nature of the property itself contributes to the service provided, it would be appropriate to reflect the cost of reproducing the existing asset in the cost of the modern equivalent. For example, in the event of loss, a parliament building may be reproduced rather than replaced with alternative accommodation, because of its significance to the community. However, where it would be impossible for a modern reproduction to recreate the original's historic significance, entities should not cost such a reproduction.

D21. Buildings of iconic status (which might or might not be historic or listed) that would be replaced by similarly iconic buildings should be valued on the basis of a modern equivalent asset but including the costs of achieving that iconic status. For example, the replacement cost of an historic court house might be that of a modern court house with the addition of either a façade in keeping with the surrounding buildings, or even a reproduction façade (a replica of the façade of the existing court house.)

#### *Restrictions on the Sale or Use of the Asset*

D22. The entity should also consider any factors that might affect the cost of replacing the service capacity of the existing asset. The existing use of the asset will be considered in the light of environmental issues such as the present and future characteristics of the location in terms of, for example, forecast demographic changes; local planning policies; national planning policies; existing restrictions on the use of the land and/or buildings; any restrictions on the sale or use of the land and/or buildings. An example of the latter might be where property was donated to a local authority 100 years ago, with restrictive clauses in the Deed of Gift so that the local authority can only use the property for the provision of named services (such as recreational or health).

#### **The Most Economic Cost**

NOTE: Paragraphs D24 and D26 are based on 7.39 and 7.40 of the conceptual framework.
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D23. **A replacement cost measure assumes the service potential of the asset is replaced in the least costly manner.**

D24. Replacement cost adopts an optimized approach and may differ from reproduction cost, which is the cost of acquiring an identical asset. Although in many cases the most economic replacement of the service potential will be by purchasing an asset that is similar to that which is controlled, replacement cost may be based on an alternative asset if that alternative would provide the same service potential more cheaply.

**Entity-Specific Value**

- D25. **Replacement cost is an entity specific value. An entity shall measure the cost of replacing an asset's service potential using the assumptions from the entity's perspective, assuming the entity acts in its own economic best interest.**
- D26. An entity need not undertake an exhaustive search of all acquisition methods to identify the least costly manner of replacing an asset's service potential, but it shall take into account all information that is reasonably available. In the absence of evidence to the contrary, because entities usually acquire their assets by the most economic means available, replacement cost reflects the procurement or construction process that an entity generally follows. Replacement cost reflect the replacement of service potential in the ordinary course of operations, and not the costs that might be incurred if an urgent necessity arose as a result of some unforeseeable event, such as a fire.

*Transaction Costs*

- D27. As an asset's replacement cost represents an entity-specific entry price to replace the service potential of the asset, transaction costs incurred in acquiring, or that would be incurred in replacing, the asset are included in its determination.

**Valuation Techniques**

- D28. **An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure the cost of replacing an asset's service potential, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.**

NOTE: paragraphs D29 and D35 are taken from IPSAS 17.47 and 17.48 (and amended).
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*Market Price or Current Replacement Cost of a Modern Equivalent Asset*

- D29. In many cases, the replacement cost of an asset can be established by reference to the buying price of a similar asset with similar remaining service potential in an active and liquid market. The replacement cost of an item of plant or equipment may be established by reference to the market buying price of components used to produce the asset or the indexed price for the same or a similar asset based on a price for a previous period. In the case of specialized buildings, other man-made structures and some equipment, values may be estimated using replacement cost, which may involve determining the asset's reproduction cost or use of the service units approach.

*Depreciated Replacement Cost*

- D30. Replacement cost is sometimes described as depreciated (or optimized depreciated) replacement cost (DRC), this valuation method measures value by calculating the current replacement cost of a modern equivalent asset and then making deductions (the 'depreciation' of DRC) for the following forms of obsolescence and optimization:

*Physical Obsolescence*

- D31. Physical obsolescence relates to any loss of service capacity due to the physical deterioration of the asset or its components resulting from its age and use. In assessing physical obsolescence, an entity should also consider any probable future routine, regular maintenance, as such maintenance may provide insight into the asset or its components' useful life and their rate of deterioration.

*Functional Obsolescence*

D32. Functional obsolescence relates to any loss of service capacity resulting from inefficiencies in the asset that is being valued compared to its modern equivalent – is the asset suitable for its current function? Functional obsolescence might occur because of advances or changes in the design and/or specification of the asset, or because of technological advances. For example, advances in health care technology might mean that the asset in use is outdated, or technological advances in military materiel could mean that hardened aircraft hangers would be replaced by different types of structures. Such advances will need to be incorporated into the assessment of functional obsolescence.

#### Economic Obsolescence

D33. Economic obsolescence relates to any loss of utility caused by economic or other factors outside the control of the entity. The loss of service capacity might be temporary or permanent. For example, a school might have been built in a residential area and designed to take 500 pupils but demographic changes have resulted in the need for only 300 school places. The determination of replacement cost will need to reflect this reduction in required service capacity.

#### *Reproduction Cost*

D34. An entity should consider very carefully whether or not to use a reproduction cost (or restoration cost) as a technique to determine replacement cost. Such considerations should include whether there is a statutory or other requirement to replace an asset with what is essentially a replica and whether an exact reproduction is possible; if not, then a technique that assesses the replacement of a modern equivalent asset is likely to be more appropriate for financial reporting purposes. The guidance in later paragraphs assumes that the replacement cost is that of a modern equivalent asset.

#### *Service Units Approach*

D35. Under the service units approach, the present value of the remaining service potential of the asset is determined by reducing the current cost of the remaining service potential of the asset before impairment to conform with the reduced number of service units expected from the asset in its impaired state. As in the reproduction cost approach, the current cost of replacing the remaining service potential of the asset before impairment is usually determined as the depreciated reproduction or replacement cost of the asset before impairment, whichever is lower.

#### *The Use of Experts to Determine Replacement Cost*

D36. In determining the replacement cost of an asset, it is probable that an entity will need to obtain the professional input of experts with an in-depth understanding of the type of asset for which the replacement cost is required. These experts are unlikely to be accountants: these may include, but not be limited to, clinicians (in respect of medical equipment); engineers (for infrastructure assets); and surveyors (for land and built property).

D37. It is important that the preparers of financial statements and the valuers have a clear understanding of each other's requirements and for the preparers of financial statements to have a basic understanding of the approach the relevant expert might adopt in providing a valuation. In the case of surveyors, for example, valuations of property will be carried out in accordance with International Valuation Standards (or their national equivalents); preparers of financial statements will need to have sufficient understanding of the principles contained in those standards in order to be able to:

- (c) Advise the valuator on the scope and objectives of any valuations for financial reporting purposes, which will include discussing the characteristics of the asset (see paragraphs D3 - D6 and D14 - D22);

- (d) Discuss and understand the valuation report, including any information about componentization and lives of those components (see paragraphs D7 - D10); and
- (e) Incorporate the valuations into the records underlying the financial statements (such as a fixed asset register and/or general ledger, for example).

### **Other Valuation Considerations**

D38. The cost of a modern equivalent asset will reflect the cost that would be incurred if the works were commissioned on the date of valuation. However, there are factors that may result in the cost of a notional replacement being different from that of creating the actual asset.

#### *Site Preparation*

D39. Work that may have been undertaken to prepare the actual site for occupation might not need to be carried out on an assumed equivalent site. An entity might therefore assume that the site being valued is level and serviced and ready for development.

#### *Phasing of Work*

D40. A large site may have been developed in phases. The cost of a modern equivalent asset would normally be based on a single phase development, and this should be measured at the building cost at the date of valuation. To reflect the assumption that a public entity cannot identify borrowing costs (the cost of capital) that relate to the construction of a specific asset, an entity should assume that the construction has happened 'instantly'. As a consequence, it follows that there will be no phasing of payments, and there will be no reflection of the cost of capital in the valuation.

#### *Optimal Working Conditions*

D41. Abnormal working conditions at the actual site are ignored if an alternative site is being valued.

#### *Additional costs arising from extending an existing property*

D42. These costs should be ignored, since the norm is that the valuation will be of a modern equivalent asset.

#### *Contract Variations*

D43. Additional construction costs because of design or specification changes should be ignored. The modern equivalent asset being valued will have the same service potential as the existing asset.

#### *Planning Changes*

D44. Entities should consider whether planning consent would need to be obtained were the modern equivalent asset to be constructed on the actual site.

## **Basis for Conclusions**

*This Basis for Conclusions accompanies, but is not part of, [draft] IPSAS [X] (ED XX)*

### **Introduction**

#### *The Purpose of Measurement in Public Sector Financial Statements*

- BC1. The purpose of measurement in public sector financial statements is to provide information about assets and liabilities that users' need for accountability and decision-making. Measurement that fairly reflects the cost of services, operational capacity and financial capacity of a public sector entity supports users' assessments of such matters as:
- (a) Whether the entity provided its services to constituents in an efficient and effective manner;
  - (b) The resources currently available for future expenditures, and to what extent there are restrictions or conditions attached to their use;
  - (c) To what extent the burden on future-year taxpayers of paying for current services has changed; and
  - (d) Whether the entity's ability to provide services has improved or deteriorated compared with the previous year.

#### *Service Delivery Objective and Public Sector Assets and Liabilities*

- BC2. Public sector measurement should take into account both the primary objective of most public entities and the type of assets and liabilities that such entities hold. The primary objective of most public sector entities is to deliver services to the public, rather than to make profits and generate a return on equity to investors. The type of assets and liabilities that a public sector entity holds is likely to reflect this objective. For example, in the public sector the primary reason for holding property, plant, and equipment and other assets is for their service potential rather than their ability to generate cash flows. Because of the types of services provided, a significant proportion of assets used by public sector entities is specialized—for example, roads and military assets. There may be a limited market for specialized assets and, even then, they may need considerable adaptation in order to be used by other operators. These factors have implications for the measurement of such assets.
- BC3. Another common feature of public sector assets is that they have restrictions on their use, which need to be taken into account when measurement aims to derive a value that reflects existing use. Measurement issues arise even where there are no restrictions and the aim is to reflect an asset's highest and best use.
- BC4. Governments and other public sector entities may hold items that contribute to the historical and cultural character of a nation or region—for example, art treasures, historical buildings, and other artifacts. They may also be responsible for national parks and other areas of natural significance with native flora and fauna. Such items and areas are not generally held for sale, even if markets exist. Rather, governments and public sector entities have a responsibility to preserve and maintain them for current and future generations.
- BC5. Governments and other public sector entities incur liabilities related to their service delivery objectives. Many liabilities arise from non-exchange transactions and include those related to programs that operate to deliver social benefits. Liabilities may also arise from governments' role

as a lender of last resort and from any obligations to transfer resources to those affected by disasters. In addition many governments have obligations that arise from monetary activities such as currency in circulation.

*Measurement of Assets and Liabilities for Financial Reporting by Public Sector Entities*

- BC6. Chapter 7 of *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) addresses measurement of assets and liabilities in the financial statements. In developing Chapter 7 the IPSASB took into account the special characteristics of the public sector, the needs of users, public sector entities' objectives, different types of assets and liabilities, and the importance of service potential.
- BC7. Where an asset is held primarily for its service potential, rather than its ability to generate future economic benefits, its measurement should provide information on the value of the asset's service potential to the entity. This was an important consideration for the IPSASB, as it developed concepts for public sector measurement and identified appropriate measurement bases for use in the public sector.
- BC8. The objective of measurement and the measurement bases in Chapter 7 of the Conceptual Framework address public sector financial reporting needs. They differ from objectives and measurement bases developed for private sector entities that operate to make a profit and value assets and liabilities in terms of their ability to generate future economic benefits, which focuses on future cash flows. The objective of measurement is:
- To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.
- BC9. The measurement bases identified in Chapter 7 are: historical cost, market value, replacement cost, net selling price, and value in use, for assets; and, historical cost, cost of fulfillment, market value, cost of release, and assumption price, for liabilities.

*Relationship Between ED, Measurement and Other IPSASs*

- BC10. During development of this ED the IPSASB considered including all requirements with respect to measurement of assets and liabilities in one Standard, in order to provide a comprehensive "one stop shop". However, the IPSASB concluded that other IPSAS should address impairment, depreciation, amortization, and any specific measurement requirements relating to the assets or liabilities covered by the IPSAS, for example the measurement of intangible assets or of employee benefit liabilities. IPSAS, *Measurement*, should provide the definitions and generic application guidance for the measurement bases identified in the Conceptual Framework and fair value. The aim is to support consistent application of measurement bases referred to in other IPSAS.
- BC11. The IPSASB decided to develop application guidance for the following four measurement bases: cost of fulfillment, fair value, historical cost, and replacement cost, because the greater need for application guidance relates to these four measurement bases. Appendices with application guidance on other measurement bases may be added in the future.

*Application Guidance on Fair Value*

- BC12. This ED has application guidance for the fair value measurement basis. During development of this ED the IPSASB considered whether the fair value measurement basis was relevant to measuring

assets and liabilities held by public sector entities. The IPSASB concluded that: there are assets and liabilities held by public sector entities, which should be measured at fair value; and, the term “fair value” should have the same meaning as that established by IFRS 13, *Fair Value Measurement*.

BC13. In reaching these two conclusions the IPSASB noted that there are references to fair value throughout IPSAS, however the IPSAS definition of fair value is derived from a pre-IFRS 13 definition. IFRS 13 defines fair value as an exit value, as follows:

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

BC14. The IPSASB’s Conceptual Framework does not include fair value in its list of measurement bases, because the IPSASB considered that the IFRS 13 meaning of fair value would not be appropriate for many public sector assets and liabilities, because it is an exit value. However, during development of this ED the IPSASB’s work on financial instruments has demonstrated that an exit-based definition of fair value is relevant for many financial instruments and more generally assets held for financial rather than operational capacity.

BC15. The IPSASB decided, with support from members of its Consultative Advisory Group (CAG), that if the term “fair value” continues to be used in IPSAS, the same meaning as that in IFRS 13 should apply. This avoids confusion and supports good quality measurement, when using this measurement basis.

BC16. In June 2018 the IPSASB approved IPSAS 41, *Financial Instruments*, which is an IFRS-aligned IPSAS. IPSAS 41 identifies fair value as a measurement basis applicable to financial instruments. The IPSASB had already decided, in September 2017, that the Public Sector Measurement project should allow for measurement at fair value, with the issue being one of how to integrate the IFRS 13 definition of fair value into IPSAS. The IPSASB decided that IPSAS, *Measurement*, should include the majority of IFRS 13 text to ensure that its definition of fair value would be consistent with that in IFRS 13, and adequately support IPSAS 41’s requirements with respect to measurement of financial instruments at fair value. On that basis the ED’s appendix with fair value application guidance has reproduced the majority of IFRS 13 text and aims to ensure that the ED’s definition of fair value is the same as that established in IFRS 13.

### **Objective (paragraph 1)**

BC17. ED XX’s objective explains that it focuses on the definition of appropriate measurement bases and their derivation. It does not establish requirements for which measurement bases should be used in IPSASs. The ED’s objective refers to the objective of measurement in the Conceptual Framework because this underpins its approach to measurement bases and their selection.

### **Scope and definitions (paragraphs 2–3)**

BC18. ED XX’s scope conveys that the Standard’s definitions of measurement bases and related application guidance applies when another IPSAS requires measurement using one of the defined measurement bases.

**Subsequent Measurement***Depreciation and Amortization*

BC19. Depreciation is a charge for the consumption of an asset over its useful life. ED XX does not address depreciation. Requirements and guidance on depreciation are provided at standards-level. For example, IPSAS 17, *Property, Plant and Equipment*, addresses:

- (a) The unit of account for depreciation,
- (b) The recognition of depreciation,
- (c) The point at which depreciation of an asset begins,
- (d) The relationship between economic and useful lives,
- (e) The circumstances under which land may be depreciated,
- (f) Depreciation methods, and
- (g) The relationship between the revenue generated by an asset and depreciation.

BC20. Amortization is the term applied to the consumption of an intangible asset that does not have a physical substance. As for depreciation, requirements and guidance are provided at standards-level, and ED XX does not address amortization. IPSAS 31, *Intangible Assets*, distinguishes intangible assets with definite and indefinite useful lives, and for the former provides requirements and guidance on amortization periods and methods and their review and residual value.

BC21. The selection of an accounting policy for measurement subsequent to initial recognition may have an impact on whether an asset is depreciated or amortized. This is determined at standards level. For example IPSAS 17 requires that assets on the revaluation model with useful lives are depreciated. IPSAS 16, *Investment Property*, does not require depreciation of an investment property that is measured in accordance with the fair value model subsequent to initial recognition. IPSAS 31 does not permit amortization of an asset that is classified as held for sale.

*Use of the Historical Cost Model or Revaluation Model*

BC22. The IPSASB accepts that the existence of accounting policy options reduces comparability between reporting entities. The IPSASB discussed whether ED, *Measurement*, should consider the options for measurement subsequent to initial recognition in existing IPSAS with a view to eliminating or reducing those options.

BC23. The IPSASB noted that Chapter Seven of the Conceptual Framework provides a measurement objective:

To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making processes.

BC24. The Conceptual Framework goes on to state that it is not possible to identify a single measurement basis that best meets the measurement objective and acknowledges both historical cost and current value measurements.

BC25. The IPSASB concluded that:

- (a) It would be inconsistent with the Conceptual Framework to eliminate existing accounting policy options for subsequent measurement; and that

- (b) Such a step would be outside the scope of this ED, which is to provide requirements and guidance on the definitions and application of measurement bases (i.e. what is meant by each measurement basis and how to derive measurement bases), rather than to specify where they should be used. The latter is a decision for individual standards.
- BC26. A decision on whether to use historical cost or current value for measurement subsequent to initial recognition is likely to be made by regulator(s) in a particular jurisdiction. The Basis for Conclusions notes that many respondents to the Conceptual Framework Consultation Paper and ED on Measurement advocated the continued widespread use of historical cost, mostly in combination with other measurement bases. Supporters of historical cost referenced the accountability objective of financial reporting, the verifiability of historical cost and its suitability for budget reporting purposes where budgets are prepared on a historical cost basis.
- BC27. Conversely those who supported current values, and adopted a view that historical cost should be used as a proxy for current value, linked this view to both decision-making and accountability, arguing that the cost of service provision should reflect the value of assets used in service provision at the time they are consumed, rather than their transaction price. Some of these views may inform the decisions of regulators.

#### Financial Instruments Measured at Historical Cost

- BC28. The amortized cost of a financial asset or financial liability reflects estimates of future cash flows discounted at a rate that is not updated after initial recognition. For loans given or received, if interest is receivable or payable regularly, the amortized cost of the loan typically approximates the amount originally paid or received. Therefore, the amortized cost of a financial asset or liability is considered to be a form of historical cost.

#### **Application guidance**

[Text in the Basis for Conclusions to be determined.]

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Exposure Draft ~~XXXX~~  
~~January–April 2019~~  
Comments due:

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## Measurement

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets IPSAS® and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

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## REQUEST FOR COMMENTS

This [Illustrative](#) Exposure Draft, *Public Sector Measurement*, was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by ~~May 15~~ [August 31](#) [September 30](#), 2019.**

Respondents are asked to submit their comments electronically through the IPSASB website, using the "[Submit a Comment](#)" link. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the website. This publication may be downloaded from the IPSASB website: [www.ipsasb.org](http://www.ipsasb.org). The approved text is published in the English language.

### Objective of the Exposure Draft

~~The objective of this [\[draft\] standard](#) Exposure Draft is to define measurement bases that assist in reflecting fairly the cost of services, operational capacity, and financial capacity and how to identify approaches under those measurement bases to be applied through individual IPSASs to achieve the objectives of financial reporting. The objective of this Exposure Draft is to propose requirements for the measurement of assets and liabilities.~~

### Guide for Respondents

~~The IPSASB would welcome comments on all of the matters discussed in this Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.~~

~~The Preliminary Views and Specific Matters for Comment requested for the Exposure Draft are provided below.~~

~~[Preliminary views and specific matters for comment will be included here.]~~

## EXPOSURE DRAFT ~~XXXX~~, MEASUREMENT

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## Objective

1. The objective of this ~~[draft] s~~Standard is to define measurement bases that assist in reflecting fairly the cost of services, operational capacity, and financial capacity and how to identify approaches under those measurement bases to be applied through individual IPSASs to achieve the objectives of financial reporting.

## Scope

2. An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this ~~[draft] IPSAS [X] (ED 68) [draft] Standard~~ in measuring items.
3. Except as specified in paragraphs ~~4X-X~~, this IPSAS applies when another IPSAS requires or permits:
  - (a) One or more of the measurement bases defined herein or disclosures about one or more of these measurement bases; and
  - (b) Measurements that are based on one or more of the measurement bases (e.g. market value less costs to sell) or disclosures about those measurements.
4. [Include exceptions here, once identified.]
5. The measurement application guidance described in this IPSAS applies to both initial and subsequent measurement.

## Definitions

~~6.~~—The following terms are used in this ~~[draft] Standard~~ with the meanings specified:

~~7-6.~~ ~~[Further defined terms will be added as necessary.]~~

**Active market** is a market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.

~~**Assumption price** is the amount which the entity would rationally be willing to accept in exchange for assuming an existing liability.~~

**Cost approach** is a valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

**Cost of fulfillment** is the costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner.

~~**Cost of release** is the amount that either the creditor will accept in settlement of its claim, or a third party would charge to accept the transfer of the liability from the obligor.~~

**Entry price** is the price paid to acquire an asset or received to assume a liability in an exchange transaction.

**Exit price** is the price received to sell an asset or paid to transfer a liability.

**Expected cash flow** is the probability-weighted average (i.e. mean of the distribution) of possible future cash flows.

**Fair value** is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

**Highest and best use** is the use of a non-financial asset by market participants that would maximize the value of the asset or the group of assets and liabilities (e.g. an operation) within which the asset would be used.

**Historical cost for an asset** is the consideration given to acquire or develop an asset, which is the cash or cash equivalents or the value of the other consideration given, at the time of its acquisition or development.

**Historical cost for a liability** is the consideration received to assume an obligation, which is the cash or cash equivalents, or the value of the other consideration received at the time the liability is incurred.

**Income approach** is valuation techniques that convert future amounts (e.g. cash flows or income and expenses) to a single current (i.e. discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.

**Inputs** are the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk, such as the following:

- (a) The risk inherent in a particular valuation technique used to measure fair value (such as a pricing model); and
- (b) The risk inherent in the inputs to the valuation technique.

Inputs may be observable or unobservable.

**Level 1 inputs** are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

**Level 2 inputs** are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

**Level 3 inputs** are unobservable inputs for the asset or liability.

**Market approach** is a valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets, liabilities or a group of assets and liabilities, such as an operation.

**Market participants** are buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

- (a) They are independent of each other, i.e. they are not related parties as defined in IPSAS 20, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms.
- (b) They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary.
- (c) They are able to enter into a transaction for the asset or liability.

- (d) They are willing to enter into a transaction for the asset or liability, i.e. they are motivated but not forced or otherwise compelled to do so.

**Market value for assets** is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

**Market value for liabilities** is the amount for which a liability could be settled between knowledgeable, willing parties in an arm's length transaction.

**Market-corroborated inputs** are inputs that are derived principally from or corroborated by observable market data by correlation or other means.

**Most advantageous market** is the market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.

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

**Non-performance risk** is the risk that an entity will not fulfil an obligation. Non-performance risk includes, but may not be limited to, the entity's own credit risk.

**Observable inputs** are inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability.

**Orderly transaction** is a transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (e.g. a forced liquidation or distress sale).

**Principal market** is the market with the greatest volume and level of activity for the asset or liability.

~~Replacement cost is the optimized depreciated replacement cost of an asset~~ **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.**

**Risk premium** is the compensation sought by risk-averse market participants for bearing the uncertainty inherent in the cash flows of an asset or a liability. Also referred to as a 'risk adjustment'.

**Transaction costs** are **incremental costs that are directly attributable to the acquisition, issue or disposal of an asset or liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the asset or liability.** ~~the costs to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability that are directly attributable to the disposal of the asset or the transfer of the liability and meet both of the following criteria:~~

~~(a) — They result directly from and are essential to that transaction.~~

~~(b) — They would not have been incurred by the entity had the decision to sell the asset or transfer the liability not been made.~~

**Transport costs** are the costs that would be incurred to transport an asset from its current location to its principal (or most advantageous) market.

**Unit of account** is the level at which an asset or a liability is aggregated or disaggregated in an IPSAS for recognition purposes.

**Unobservable inputs** are inputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability.

~~Value in use is the present value to the entity of the asset's remaining service potential or ability to generate 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.~~

**Terms defined in other IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.**

## Measurement

7. When another IPSAS establishes measurement requirements with reference to one or more of the measurement bases below an entity shall apply the application guidance in the relevant appendix to derive each measurement basis:

- (a) Cost of fulfillment;
- (b) Fair value;
- (c) Historical cost; and
- (d) Replacement cost.

### *Assumption price*

- ~~8. In the context of an activity that is carried out with a view to profit, an entity will assume a liability only if the amount it is paid to assume the liability is greater than the cost of fulfillment or release—i.e., the settlement amount. Once that assumption price has been received by the entity, the entity has an obligation to its creditor.~~
- ~~9. At the time a liability is first incurred in an exchange transaction, assumption price represents the amount that was accepted by the entity for assuming the liability—it is therefore usually reasonable to assume that assumption price is the price that the entity would rationally accept for assuming a similar liability. It would charge a higher amount, if competitive pressures allowed it to do so, but it might be unwilling to accept a lower price. Just as replacement cost is a current value so, conceptually, is assumption price. There are, however, practical problems in reflecting changes in prices in obligations that are stated at assumption price.~~
- ~~10. A consequence of stating performance obligations at the assumption price is that no surplus is reported at the time the obligation is taken on. A surplus or deficit is reported in the financial statements in the period when fulfillment (or release) takes place, as it is the difference between the revenue arising from satisfaction of the liability and the cost of settlement.~~
- ~~11. An entity may have a potential obligation that is larger than assumption price. If the entity has to seek release from a contract, the other party to the contract may be able to claim recompense for losses that it will sustain, as well as the return of any amounts paid. However, provided that the entity can settle the obligation by fulfillment, it can avoid such additional obligations and it is representationally faithful to report the obligation at no more than assumption price—this is analogous to the position~~

~~where an asset will yield greater benefits than replacement cost. Under such circumstances, replacement cost rather than value in use is the most relevant measurement basis.~~

### *Cost of fulfillment*

Paragraph 88 is based on the IASB's Conceptual Framework paragraph 6.17

- ~~12. Cost of fulfillment is the costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner. Where the cost of fulfillment depends on uncertain future events, all possible outcomes are taken into account in the estimated cost of fulfillment, which aims to reflect all those possible outcomes in an unbiased manner.~~
- ~~13. Where fulfillment requires work to be done—for example, where the liability is to rectify environmental damage—the relevant costs are those that the entity will incur. This may be the cost to the entity of doing the remedial work itself, or of contracting with an external party to carry out the work. However, the costs of contracting with an external party are only relevant where employing a contractor is the least costly means of fulfilling the obligation.~~
- ~~14. Where fulfillment will be made by the entity itself, the fulfillment cost does not include any surplus, because any such surplus does not represent a use of the entity's resources. Where fulfillment amount is based on the cost of employing a contractor, the amount will implicitly include the profit required by the contractor, as the total amount charged by the contractor will be a claim on the entity's resources—this is consistent with the approach for assets, where replacement cost would include the profit required by a supplier, but no profit would be included in the replacement cost for assets that the entity would replace through self-construction.~~
- ~~8. Where fulfillment will not take place for an extended period, the cash flows need to be discounted to reflect the value of the liability at the reporting date. The cost of fulfillment is the present value of the cash, or other economic resources, that the entity expects to be obliged to transfer as it fulfils a liability. Those amounts of cash or other economic resources include not only the amounts to be transferred to the liability counterparty, but also the amounts that the entity expects to be obliged to transfer to other parties to enable it to fulfil the liability.~~

Paragraph 99 is based on the IASB's Conceptual Framework paragraph 6.19 and 6.20

- ~~9. The cost of fulfillment cannot be observed directly and is determined using cash-flow-based measurement techniques. The cost of fulfillment reflects entity-specific assumptions rather than assumptions used by market participants. In practice, there may be little difference between the assumptions that a market participant would apply and those that the entity uses itself.~~

Paragraph 1040 is based on the IASB's Conceptual Framework paragraph 6.20

- ~~15.10. The cost of fulfillment value reflects the same factors as those reflected in fair value measurement, but from an entity-specific perspective, rather than from a market-participant perspective.~~

Fair Value

Paragraph 11, 12 and 13 are based on the IASB's Conceptual Framework 6.10, 6.13 and 6.14

11. Fair value measurement provides monetary information about assets, liabilities and related revenues and expenses, using information updated to reflect conditions at the measurement date. Fair value therefore reflects changes in the values of assets and liabilities since the previous measurement date. Unlike historical cost, the current value of an asset or liability is not derived, even in part, from the transaction or event that gave rise to the asset or liability.
12. Fair value reflects the perspective of market participants. The asset or liability is measured using the same assumptions that a market participant would use when pricing the asset or liability if those market participants act in their economic best interest.
13. In some cases, fair value can be determined directly by observing prices in an active market. In other cases, it is determined indirectly using measurement techniques.

Cost of release

16. ~~Cost of release refers to the amount of an immediate exit from the obligation. Cost of release is the amount that either the creditor will accept in settlement of its claim, or 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—this is consistent with the approach for assets, where net selling price would not reflect the amount that would be received on sale to a scrap dealer, if a higher price could be obtained from sale to a purchaser who would use the asset.~~
17. ~~For some liabilities, particularly in the public sector, transfer of a liability is not practically possible and cost of release will therefore be the amount that the creditor will accept in settlement of its claim. This amount will be known if it is specified in the agreement with the creditor—for example, where a contract includes a specific cancellation clause.~~

~~In some cases there may be evidence of the price at which a liability may be transferred—for example, in the case of some pension liabilities. Transferring a liability may be distinguished from entering into an agreement with another party that will fulfill the entity's obligation or bear all the costs stemming from a liability. For a liability to be transferred it is necessary that all of the creditor's rights against the entity are extinguished. If this is not the effect of an arrangement, the liability remains a liability of the entity.~~*Fair value*

18. ~~Fair value is a market based measurement, not an entity specific measurement. For some assets and liabilities, observable market transactions or market information might be available. For other assets and liabilities, observable market transactions and market information might not be available. However, the objective of a fair value measurement in both cases is the same to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions (i.e., an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).~~
19. ~~When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that maximizes the use of relevant observable inputs and minimizes the use of unobservable inputs. Because fair value is a market-based measurement, it is measured using~~

~~the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfill a liability is not relevant when measuring fair value.~~

- ~~20. The definition of fair value focuses on assets and liabilities because they are a primary subject of accounting measurement. In addition, this IPSAS shall be applied to an entity's own equity instruments measured at fair value.~~

#### *Historical cost*

[Paragraph 1414 is based on the IASB's Conceptual Framework paragraph 6.4 and IPSASB's Conceptual Framework 7.14](#)

14. Historical cost is an entry, entity-specific value. (The term "historical cost" may also be referred to as the "cost model" or generically as "cost-based measures-"). [Historical cost measures provide monetary information about assets, liabilities and related revenue and expenses, using information derived, at least in part, from the price of the transaction or event that gave rise to them.](#)

[Paragraph 1545 and 1646 are based on the IPSASB's Conceptual Framework 7.14 and 7.15](#)~~Under the historical cost model assets are initially reported at the cost incurred on their acquisition.~~

- ~~21.~~15. Subsequent to initial recognition, this cost may be allocated as an expense to reporting periods in the form of depreciation or amortization for certain assets, as the service potential or ability to generate economic benefits provided by such assets are consumed over their useful lives. Following initial recognition, the measurement of an asset is not changed to reflect changes in prices or increases in the value of the asset.

16. Under the historical cost model the amount of an asset may be reduced by recognizing impairments. Impairment is the extent to which the service potential or ability to generate economic benefits provided by an asset have diminished due to changes in economic or other conditions, as distinct to their consumption. This involves assessments of recoverability. Conversely, the amount of an asset may be increased to reflect the cost of additions and enhancements (excluding price increases for unimproved assets) or other events, such as the accrual of interest on a financial asset.

[Paragraph 1747 and 1848 are based on the IPSASB's Conceptual Framework 7.71 and 7.72](#)

- ~~22.~~17. When measuring liabilities under the historical cost model initial measures may be adjusted to reflect factors such as the accrual of interest, the accretion of discount or amortization of a premium.

18. Where the time value of a liability is material—for example, where the length of time before settlement falls due is significant—the amount of the future payment is discounted so that, at the time a liability is first recognized, it represents the value of the amount received. The difference between the amount of the future payment and the present value of the liability is amortized over the life of the liability, so that the liability is stated at the amount of the required payment when it falls due.

[Paragraph 1949 is based on the IASB's Conceptual Framework paragraph 6.9](#)

- ~~23.~~19. [One way to apply a historical cost measurement basis to a financial asset or financial liability is to measure them at amortized cost. The amortized cost of a financial asset or financial liability reflects estimates of future cash flows, discounted at a rate determined at initial recognition. For](#)

variable rate instruments, the discount rate is updated to reflect changes in the variable rate. The amortized cost of a financial asset or financial liability is updated over time to depict subsequent changes, such as the accrual of interest, the impairment of a financial asset and receipts or payment.

#### *Net selling price*

~~24. Net selling price is the amount that the entity can obtain from sale of the asset, after deducting the costs of sale. An asset cannot be worth less to the entity than the amount it could obtain on sale of the asset. Net selling price differs from market value in that it does not require an open, active and orderly market or the estimation of a price in such a market and that it includes the entity's costs of sale. Net selling price therefore reflects constraints on sale. It is entity specific.~~

#### *Replacement cost*

Paragraph 2020, 2124 and 2323 are based on the IASB's Conceptual Framework 6.21 and 6.22

~~20. 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. Replacement cost is equivalent to the optimized depreciated replacement cost, which denotes that replacement cost refers to the replacement of the service potential embodied in an asset and not the asset itself. The replacement cost of an asset is the cost of an equivalent asset at the measurement date, comprising the consideration that would be paid at the measurement date, plus the transaction costs that would be incurred at the at date.~~

~~21. Replacement cost, like historical cost, is an entry value. It reflects prices in the market in which the entity would acquire the asset. However, unlike historical cost, replacement cost reflects conditions at the measurement date.~~

Paragraph 2222 is based on the IPSASB's Conceptual Framework 7.38

~~25-22. Replacement cost differs from market fair value because it:~~

- ~~(a) Is explicitly an entry value that reflects the cost of replacing the service potential of an asset;~~
- ~~(b) Includes all the costs that would necessarily be incurred in the replacement of the service potential of an asset; and~~
- ~~(c) Is entity specific and therefore reflects the economic position of the entity, rather than the position prevailing in a hypothetical market. (For example, the replacement cost of a vehicle is less for an entity that usually acquires a large number of vehicles in a single transaction and is regularly able to negotiate discounts than for an entity that purchases vehicles individually.)~~

~~26. Because entities usually acquire their assets by the most economic means available, replacement cost reflects the procurement or construction process that an entity generally follows. Replacement cost reflects the replacement of service potential in the normal course of operations, and not the costs that might be incurred if an urgent necessity arose as a result of some unforeseeable event, such as a fire.~~

~~27. Replacement cost is the cost of replacing an asset's service potential. Replacement cost adopts an optimized approach and differs from reproduction cost, which is the cost of acquiring an identical asset. (There may be cases where replacement cost equates to reproduction cost. This is where the most economic way of replacing service potential is to reproduce the asset.) Although in many cases~~

~~the most economic replacement of the service potential will be by purchasing an asset that is similar to that which is controlled, replacement cost is based on an alternative asset if that alternative would provide the same service potential more cheaply. For financial reporting purposes, it is therefore necessary to reflect the difference in service potential between the existing and replacement asset.~~

- ~~28. The appropriate service potential is that which the entity is capable of using or expects to use, having regard to the need to hold sufficient service capacity to deal with contingencies. Therefore, the replacement cost of an asset reflects reductions in required service capacity. For example, if an entity owns a school that accommodates 500 pupils but, because of demographic changes since its construction, a school for 100 pupils would be adequate for current and reasonably foreseeable requirements, the replacement cost of the asset is that of a school for 100 pupils.~~
- ~~23. In some cases the value that will be derived from an asset will be greater than its replacement cost. However, it would not be appropriate to measure the asset at that value, as it includes benefits from future activities, rather than service potential at the reporting date. Replacement cost represents the highest potential value of an asset, as, by definition, the entity is able to secure equivalent service potential by incurring replacement cost. In some cases, replacement cost cannot be determined directly by observing prices in an active market and must be determined indirectly by other means. For example, if prices are available for a new asset, the current cost of a used asset might need to be estimated by adjusting the current price of a new asset to reflect the current age and condition of the asset held by the entity.~~

~~29. —~~

## **Measurement**

- ~~30. When another IPSAS establishes measurement requirements with reference to one or more of the measurement bases below an entity shall apply the application guidance in the relevant appendix to derive each measurement basis:~~
- ~~(a) Cost of fulfilment;~~
  - ~~(b) Fair value;~~
  - ~~(c) Historical cost; and~~
  - ~~(d) Replacement cost.~~

## **Transaction Costs**

- ~~24. Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.~~
- ~~25. Incremental costs are a direct result of the transaction. Transaction costs are an essential feature of the transaction, and they would not have been incurred had the transaction not occurred. For example, while costs to operate an asset after it has been acquired are incremental costs because they would not be incurred if the entity had not acquired the asset, these costs are not transaction costs as they are not a direct result of the transaction.~~

26. Costs attributable to the acquisition of an asset relate specifically to costs of ownership transfer. Costs incurred prior to transfer (for example, costs to negotiate the transaction), or costs incurred subsequent to the transfer, (for example, borrowing costs), are excluded from the definition of transaction costs.
27. Including transaction costs in the measurement of an asset or liability is dependent on the objective of measurement. Whether an entity is presenting an entry based measurement basis or an exit based measurement basis impacts whether those transaction costs are included or excluded from measurement.
28. Transaction costs can arise both, when an asset is acquired or a liability is incurred, and when an asset is sold or disposed of or a liability is settled or transferred. Transaction costs incurred in acquiring an asset or incurring a liability are a feature of the transaction in which the asset was acquired or the liability was incurred. As such, transaction costs incurred in entering into a transaction are included in entry based measurement bases. Transaction costs that would be incurred in selling or disposing of an asset or in settling a transferring a liability are a future of a possible future transaction. As such, transaction costs that would be incurred in exiting a transaction are included in exit based measurement bases when the measurement base is entity-specific.

## Disclosures

31. ~~An entity shall disclose the information listed in the relevant application guidance appendix of this Standard when using one or more of those measurement bases to measure assets and/or liabilities.~~
32. ~~Appendices A–D to this Standard, which have application guidance for cost of fulfillment, fair value, historical cost, and replacement cost, also list disclosures that an entity should make, when applying each measurement basis.~~

## Effective Date

- ~~33-29.~~ **An entity shall apply this [draft] Standard for annual financial statements covering periods beginning on or after MMMM DD, YY. Earlier adoption is encouraged. If an entity applies this [draft] Standard for a period beginning before MMMM DD, YY, it shall disclose that fact.**
- ~~34-30.~~ When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this [draft] Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

## Application Guidance Appendices

*These application guidance appendices are an integral part of [draft] IPSAS [X] (ED XX)<sup>4</sup>*

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<sup>4</sup>—These appendices are expected to provide application guidance on, inter alia, the topics identified in paragraph 10(b) of agenda paper 8.2.1.

## Appendix A: Cost of fulfillment–application guidance

*This Appendix is an integral part of [\[draft\] IPSAS \[X\] \(ED XX\) IPSAS XX, Measurement](#).*

### Measurement

- A1. The objective of cost of fulfillment measurement is to estimate the value of a liability assuming the entity will fulfill its obligation in the least costly manner. A cost of fulfillment measurement requires an entity to determine all the following:
- (a) The particular liability that is the subject of the measurement (consistently with its unit of account).
  - (b) The manner in which the liability will be settled.
  - (c) The liability's expected timing of settlement.
  - (d) The valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the liability.

### The ~~liability~~Liability

- A2. **A cost of fulfillment measurement is for a particular liability. Therefore, when measuring the cost of fulfillment, an entity takes into account characteristics of the particular liability relevant in determining the cost of fulfillment at the measurement date. Such characteristics include, for example, the following:**
- (a) **The entity's expectations about the amount and timing of the future outflow of resources; and**
  - (b) **The risk that the actual future outflow of resources may ultimately differ from those expected (i.e. a risk premium).**
- A3. The effect on the measurement arising from a particular characteristic will differ depending on how that characteristic would be taken into account by the specific entity.
- A4. The liability measured at its cost of fulfillment might be either of the following:
- (a) A stand-alone liability (e.g., a legal claim against the entity); or
  - (b) A group of liabilities (e.g., decommissioning liabilities associated with a particular asset).
- A5. Whether the liability is a stand-alone liability or a group liabilities for recognition or disclosure purposes depends on the liability's unit of account. The unit of account for the liability shall be determined in accordance with the IPSAS that requires or permits the cost of fulfillment measurement, except as provided in this Application Guidance.

### The ~~least~~~~Least~~ ~~costly~~Costly mannerManner

- A6. **The cost of fulfillment measurement assumes that the liability is settled by the entity in the least costly manner.**
- A7. The cost of fulfillment represents the amount the entity is obligated to incur to settle the liability. This obligation represents the minimum amount an entity will incur assuming the entity completely satisfies its obligation. For example, an entity may have an obligation to restore a parcel of land to its original condition when a temporary road is no longer in use. Even when the entity intends to enhance the

parcel of land, the costs of enhancements are beyond the cost to fulfill the minimum obligation of restoring the land to its original condition and therefore are not representative of the cost to fulfill the liability. In cases where an entity intends to fulfill the liability beyond its commitment, guidance in IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets, should be applied when accounting for amount in excess of the cost to fulfill.

A7-A8. An entity need not undertake an exhaustive search of all settlement methods to identify the least costly manner of settlement, but it shall take into account all information that is reasonably available. In the absence of evidence to the contrary, the least costly manner of settlement is presumed to be the manner in which the entity has currently selected to release itself from the obligation. For example, if an entity elects to fulfill its decommissioning liability using its own employees, it is presumed this is the least costly manner of settlement, regardless of the entity's ability to contract the decommissioning to third parties.

~~A8. Once an entity has a designated settlement method, the cost of fulfillment measurement shall be based on this method, even if the cost using a different method is potentially more advantageous at the measurement date. Once an entity designates a settlement method, whether a less costly method exists is irrelevant as the entity cannot access this secondary method.~~

A9. The entity must have the ability to access the settlement method that results in the obligation being settled in the least costly manner at the expected settlement date. Because different entities (and operations within those entities) with different activities may have access to a variety of settlement methods, the least costly manner for the same liability might be different for different entities (and operations within those entities). Therefore, the least costly manner shall be considered from the perspective of the entity, thereby allowing for differences between and among entities with different activities.

Paragraph A10A10 is based on the Conceptual Framework 7.76

A10. Where fulfillment requires work to be done—for example, where the liability is to rectify environmental damage—the relevant costs are those that the entity will incur. This may be the cost to the entity of doing the remedial work itself, or of contracting with an external party to carry out the work. However, the costs of contracting with an external party are only relevant where employing a contractor is the least costly means of fulfilling the obligation.

Paragraph A11A11 is based on the Conceptual Framework 7.77

A9-A11. Where fulfillment will be made by the entity itself, the fulfillment cost does not include any surplus, because any such surplus does not represent a use of the entity's resources. Where the cost of fulfillment amount is based on the cost of employing a contractor, the amount will implicitly include the profit required by the contractor, as the total amount charged by the contractor will be a claim on the entity's resources.

#### **Entity-specific Specific valueValue**

A10-A12. **The cost of fulfillment is an entity specific value. An entity shall measure the cost of fulfillment of a liability using the assumptions from the entity's perspective, assuming the entity acts in its own economic best interest.**

~~A11-A13.~~ 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).

~~A12-A14.~~ When measuring an entity specific value, the estimate of risk premium and the time value of money should be market based. This does not require an entity to use the same assumptions as a market participant, however maximizing the use of market based assumptions is required. For example, when discounting future cash flows, a market based discount rate should be applied where appropriate.

~~A13-A15.~~ Accordingly, the risk premium and time value of money in an entity specific measure of a liability should be the amount market participants would apply if their estimates of the amount and timing of the future outflow of resources were the same as the entity's estimates.

**The ~~cost~~ Cost that the ~~entity~~ Entity will ~~Will~~ incur ~~Incur~~**

~~A14-A16.~~ **The cost of fulfillment estimates the cost assuming the entity fulfills its obligation.**

~~A15-A17.~~ A cost of fulfillment measurement, both at initial and subsequent measurement, should only incorporate the future outflows of resources the entity expects to incur to satisfy the obligation.

~~A18.~~ The price used to measure the cost of fulfilling the liability shall not be adjusted for *transaction costs incurred to enter into the transaction*. ~~Transaction costs shall be accounted for in accordance with other IPSASs. Entry-based T~~ Transaction costs are not a characteristic of a liability; rather, they are specific to a transaction and will differ depending on how an entity enters into a transaction for the liability have no impact on the future outflows of resources the entity expects to incur. In contrast, transaction costs that are expected to be incurred, or exit-based, in settling the liability are a future outflow of resources that is relevant in measuring the cost to fulfill the liability and are included in measuring the cost of fulfillment.

Paragraph A19A19 is based on the Conceptual Framework 7.75

~~A19.~~ Where the cost of fulfillment depends on uncertain future events, all possible outcomes are taken into account in the estimated cost of fulfillment, which aims to reflect all those possible outcomes in an unbiased manner.

Paragraph A20A20 is based on the Conceptual Framework 7.78

~~A16-A20.~~ Where settlement of the obligation will not take place for an extended period, the cash flows need to be discounted to reflect the value of the liability at the measurement date using a valuation technique. As a practical expedient, 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.

**Fulfilling its ~~obligations~~Obligations**

**~~A17-A21.~~ A17-A21. The cost of fulfillment is the cost that the entity expects to incur to settle its obligation in the normal course of operations.**

**~~A18-A22.~~ A18-A22. In estimating the cost to settle its obligation in the normal course of operations, the entity assumes the obligation will be fulfilled under the existing terms of the arrangement, with the current counterparty and that the liability will not be transferred to a third party.**

**~~A19-A23.~~ A19-A23. In estimating the cost of fulfillment the entity takes into account all readily available information at the measurement date under current market conditions in estimating the outflow of resources required to settle the liability at the expected settlement date.**

**~~A20-A24.~~ A20-A24. The cost of fulfillment shall not include the non-performance risk of the entity to settle its obligation. Non-performance risk is the risk that an entity will not fulfil its obligations and it is a characteristic of a liability. However, in estimating the cost of fulfilling a liability, an entity should not include non-performance risk in its estimate.**

**~~A21-A25.~~ A21-A25. A cost of fulfillment measurement is a measure of the value of a liability assuming the entity will fulfil its obligations. As non-performance risk takes into account the effect on the value of a liability of the entity potentially not meeting its obligations it is inconsistent to include in the measure of a liability the possibility that it may not meet its obligations when the cost of fulfillment measurement assumes the liability will be fulfilled in the normal course of operations.**

**Valuation ~~techniques~~Techniques**

**~~A22-A26.~~ A22-A26. An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure the cost of fulfillment, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.**

**~~A23-A27.~~ A23-A27. The objective of using a valuation technique is to estimate the cost that the entity will incur in fulfilling the obligations represented by the liability at the measurement date under current market conditions. The most commonly used valuation approach when measuring the cost of fulfillment is an income approach. The main aspects of that approach as it relates to the cost of fulfillment are summarized in paragraphs ~~A28-A2828~~ A28-A2828–~~A61A6161~~ A61A6161.**

*Income ~~approach~~Approach*

**~~A24-A28.~~ A24-A28. The income approach converts future outflows of resources (e.g., cash flows) to a single current (i.e., discounted) amount. When the income approach is used, the cost of fulfillment measurement reflects current market expectations about those future amounts.**

**~~A25-A29.~~ A25-A29. The most commonly used valuation techniques when measuring the cost of fulfillment are present value techniques. (see paragraphs ~~A30A3030~~ A30A3030–~~A61A6161~~ A61A6161);**

*Present ~~value~~Value ~~techniques~~Techniques*

**~~A26-A30.~~ A26-A30. Paragraphs ~~A31A3131~~ A31A3131–~~A61A6161~~ A61A6161 describe the use of present value techniques to measure the cost of fulfillment. Those paragraphs neither prescribe the use of a single specific present value technique nor limit the use of present value techniques to measure the cost of fulfillment to the techniques discussed. The present value technique used to measure the cost of fulfillment will depend on facts and circumstances specific to the liability being measured and the availability of sufficient data.**

The ~~components~~Components of a ~~present~~Present ~~value~~Value ~~measurement~~Measurement

~~A27-A31.~~ A31. Present value (i.e., an application of the income approach) is a tool used to link future amounts (e.g., cash flows) to a present amount using a discount rate. A cost of fulfillment measurement of a liability using a present value technique captures all the following elements from the entity's perspective at the measurement date:

- (a) An estimate of future outflows of resources for the liability being measured.
- (b) Expectations about possible variations in the amount and timing of the outflows of resources representing the uncertainty inherent in the outflows of resources.
- (c) The time value of money, represented by the rate on risk-free monetary liabilities that have maturity dates or durations that coincide with the period covered by the outflows of resources and pose neither uncertainty in timing nor risk of default to the holder (i.e., a risk-free interest rate).
- (d) The price for bearing the uncertainty inherent in the outflows of resources (i.e., a risk adjustment).
- (e) Other factors that the entity would take into account in the circumstances.

#### General ~~principles~~ Principles

~~A28-A32.~~ A32. Present value techniques differ in how they capture the elements in paragraph ~~A31~~A31-A34. However, all the following general principles govern the application of any present value technique used to measure the cost of fulfillment:

- (a) Outflows of resources and discount rates should reflect entity specific assumptions that market participants would use when pricing the liability that is expected to be settled through fulfillment of the arrangement.
- (b) Outflows of resources and discount rates should take into account only the factors attributable to the liability being measured.
- (c) To avoid double-counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the outflows of resources. For example, a discount rate that reflects the uncertainty in expectations about future defaults is appropriate if using contractual cash flows of a loan (i.e., a discount rate adjustment technique). That same rate should not be used if using expected (i.e., probability-weighted) cash flows (i.e., an expected present value technique) because the expected cash flows already reflect assumptions about the uncertainty in future defaults; instead, a discount rate that is commensurate with the risk inherent in the expected cash flows should be used.
- (d) Assumptions about outflows of resources and discount rates should be internally consistent. For example, nominal cash flows, which include the effect of inflation, should be discounted at a rate that includes the effect of inflation. The nominal risk-free interest rate includes the effect of inflation. Real cash flows, which exclude the effect of inflation, should be discounted at a rate that excludes the effect of inflation. Similarly, after-tax cash flows should be discounted using an after-tax discount rate. Pre-tax cash flows should be discounted at a rate consistent with those cash flows.
- (e) Discount rates should be consistent with the underlying economic factors of the currency in which the outflows of resources are denominated.

#### Risk ~~adjustment~~ Adjustment

[A29-A33.](#) A cost of fulfillment measurement using present value techniques is made under conditions of uncertainty because the actual resource flows may ultimately differ from those expected. In many cases both the amount and timing of the outflows of resources are uncertain. Even contractually fixed amounts, such as the payments on a loan, are uncertain if there is a prepayment option.

[A30-A34.](#) A cost of fulfillment measurement should include a risk based on the entity's estimates of future outflows of resources. The estimated risk premium for a cost of fulfillment measurement is an entity specific assumption. This risk premium does not represent the market risk premium reflecting the amount market participants would demand for bearing the risk that the actual outflows of resources maybe different from their expectations, however, it does reflect the entity's expectation of the variability in timing and amounts related to the flows of resources. The risk adjustment measures the compensation that the entity would require to make the entity indifferent between:

- (a) Fulfilling a liability that has a range of possible outcomes; and
- (b) Fulfilling a liability that will generate fixed outflows of resources with the same expected present value as the liability being measured.

For example, the risk adjustment would measure the compensation that the entity would require to make it indifferent between fulfilling a liability that has a 50 per cent probability of being CU90 and a 50 per cent probability of being CU110 and fulfilling a liability that is fixed at CU100. As a result, the risk adjustment conveys information to users of financial statements about the entity's perception of the effects of uncertainty about the amount and timing of cash flows that arise from a liability.

[A31-A35.](#) The risk adjustment shall reflect all risks associated with the liability. It shall not reflect the risks that do not arise from the liability, such as general operational risk that relates to future transactions.

[A32-A36.](#) The risk adjustment shall be included in the measurement in an explicit way. Thus, in principle, the risk adjustment is separate from the estimates of future outflow of resources and the discount rates that adjust those outflow of resources for the time value of money. The entity shall not double-count the risk adjustments by, for example, including the risk adjustment implicitly when determining the estimates of future outflow of resources or the discount rates.

[A33-A37.](#) This Appendix does not specify the technique that is used to determine the risk adjustment. However, to meet the objective in paragraph [A3434](#), the risk adjustment shall have the following characteristics:

- (a) Risks with low frequency and high severity will result in higher risk adjustments than risks with high frequency and low severity;
- (b) For similar risks, contracts with a longer duration will result in higher risk adjustments than contracts with a shorter duration;
- (c) Risks with a wide probability distribution will result in higher risk adjustments than risks with a narrower distribution;
- (d) The less that is known about the current estimate and its trend, the higher the risk adjustment; and
- (e) To the extent that emerging experience reduces uncertainty, risk adjustments will decrease and vice versa.

[A34-A38.](#) 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.

*Future ~~Outflows of resources~~Resources*

~~A35-A39.~~ A39. The estimates of outflows of resources used to determine the cost of fulfillment shall include all inflows of resources and outflows of resources that relate directly to the fulfillment of the liability. Those estimates shall:

- (a) Be explicit (i.e., the entity shall estimate those outflows of resources separately from the estimates of discount rates that adjust those future outflows of resources for the time value of money and the risk adjustment that adjusts those future outflows of resources for the effects of uncertainty about the amount and timing of those outflows of resources);
- (b) Reflect the perspective of the entity, provided that the estimates of any relevant market variables do not contradict the observable market prices for those variables (see paragraphs ~~A43A4343–A47A4747~~);
- (c) Incorporate, in an unbiased way, all of the available information about the amount, timing and uncertainty of all of the inflows of resources and outflows of resources that are expected to arise as the entity fulfils the liability (see paragraph ~~A48A4848~~); and
- (d) Be current (i.e., the estimates shall reflect all of the available information at the measurement date) (see paragraphs ~~A49A4949–A53A5353~~).

Uncertainty and the ~~expected-Expected value-Value approach~~Approach

~~A36-A40.~~ A40. The expected present value technique uses as a starting point a set of outflows of resources that represents the probability-weighted average of all possible future outflows of resources (i.e., the expected outflows of resources). The resulting estimate is identical to expected value, which, in statistical terms, is the weighted average of a discrete random variable's possible values with the respective probabilities as the weights. Because all possible outflows of resources are probability-weighted, the resulting expected outflows of resources is not conditional upon the occurrence of any specified event (unlike the outflows of resources used in the discount rate adjustment technique).

~~A37-A41.~~ A41. In determining the expected outflows of resources an entity must:

- (a) Identify each possible outcome;
- (b) Make an unbiased estimate of the amount and timing of the future outflows of resources for each outcome;
- (c) Make an unbiased estimate of the probability of each outcome.

~~A38-A42.~~ A42. Paragraph ~~A41A4141~~ requires the estimate of expected values reflect an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes. In practice, this may not need to be a complex analysis. In some cases, relatively simple modelling may be sufficient, without the need for a large number of detailed simulations of scenarios. For example, the identification of scenarios that specify the amount and timing of the outflows of resources for particular outcomes and the estimated probability of those outcomes will probably be needed. In those situations, the expected outflows of resources shall reflect at least two outcomes.

Market ~~variables-Variables~~ and ~~nonNon-market-Market variables-Variables~~ (paragraph-Paragraph ~~A39(b)A39(b)39(b)~~)

~~A39-A43.~~ A43. This application guidance identifies two types of variables:

- (a) Market variables—variables that can be observed in, or derived directly from, markets (for example, interest rates); and
- (b) Non-market variables—all other variables (for example, the frequency and severity of natural disasters impacting decommissioning liabilities).

Market ~~variables~~ Variables

A40-A44. Estimates of market variables shall be consistent with observable market prices at the end of the reporting period. An entity shall not substitute its own estimates for observed market prices except as described in paragraph 66 of Appendix B. In accordance with Appendix B, if market variables need to be estimated (for example, because no observable market variables exist), they shall be as consistent as possible with observable market variables.

Non-market ~~Market variables~~ Variables

A41-A45. Estimates of non-market variables shall reflect all of the available evidence, both external and internal.

A42-A46. Non-market external data (for example, national statistics for decommissioning of a nuclear power facility) may have more or less relevance than internal data (for example, internally developed statistics for decommissioning of a nuclear power facility), depending on the circumstances.

A43-A47. Estimated probabilities for non-market variables shall not contradict observable market variables. For example, estimated probabilities for future inflation rate scenarios shall be as consistent as possible with probabilities implied by market interest rates.

Estimating ~~probabilities~~ Probabilities of ~~future~~ Future payments ~~Payments~~ (~~paragraph~~ Paragraph A39(c) ~~A39(c)~~ A39(e))

A44-A48. An entity estimates the probabilities associated with future payments under existing contracts on the basis of:

- (a) Information about the known or estimated characteristics of the liability;
- (b) Historical data about the entity's own experience, supplemented when necessary with historical data from other sources. Historical data is adjusted if, for example:
  - (i) The characteristics of the liability differ (or will differ, for example because of adverse selection) from those of the population that has been used as a basis for the historical data;
  - (ii) There is evidence that historical trends will not continue, that new trends will emerge or that economic or other changes may affect the outflow of resources that arise from the existing liability; or
  - (iii) There have been changes in the entity's practices or procedures that may affect the relevance of historical data to the liability.

Under ~~current~~ Current estimates ~~Estimates~~ (~~paragraph~~ Paragraph A39(d) ~~A39(d)~~ A39(d))

A45-A49. In estimating the probability of each outflow of resources scenario, an entity shall use all of the available current information at the end of the reporting period. An entity shall review the estimates of the probabilities that it made at the end of the previous reporting period and update them for any changes. In doing so, an entity shall consider whether:

- (a) The updated estimates faithfully represent the conditions at the end of the reporting period; and
- (b) The changes in estimates faithfully represent the changes in conditions during the period. For example, suppose that estimates were at one end of a reasonable range at the beginning of the period. If the conditions have not changed, changing the estimates to the other end of the range at the end of the period would not faithfully represent what has happened during the whole period. If an entity's most recent estimates are different from its previous estimates, but conditions have not changed, it shall assess whether the new probabilities that are assigned to each scenario are justified. In updating its estimates of those probabilities, the entity shall consider both the evidence that supported its previous estimates and all of the new available evidence, giving more weight to the more persuasive evidence.

A46-A50. The probability assigned to each scenario shall reflect the conditions at the end of the reporting period. Consequently, in accordance with IPSAS 14, *Events after the Reporting Date*, an event that occurs after the end of the reporting period and resolves a condition that existed at the reporting date does not provide evidence of a condition that existed at the end of the reporting period. For example, there may be a 20 per cent probability at the end of the reporting period that a major storm will strike prior to a facility being decommissioned that would increase the cost of decommission. After the end of the reporting period and before the financial statements are authorized for issue, a storm strikes. The outflow of resources under that contract shall not reflect the storm that, with hindsight, is known to have occurred. Instead, the outflow of resources that were included in the measurement are multiplied by the 20 per cent probability that was apparent at the end of the reporting period (with appropriate disclosure, in accordance with IPSAS 14, that a non-adjusting event occurred after the end of the reporting period).

Future Events (~~paragraph Paragraph A39(d)~~~~A39(d)~~~~39(d)~~)

A47-A51. Estimates of non-market variables shall consider not just current information about the liabilities but also information about trends. For example, technology has consistently improved over long periods decreasing decommissioning costs. The determination of the outflow of resources reflects the probabilities that would be assigned to each possible trend scenario in the light of all of the available evidence.

A48-A52. Similarly, if the outflow of resources associated with fulfilling the liability are sensitive to inflation, the determination of the outflow of resources shall reflect possible future inflation rates. Because inflation rates are likely to be correlated with interest rates, the measurement of the outflow of resources reflects the probabilities for each inflation scenario in a way that is consistent with the probabilities that are implied by market interest rates.

A49-A53. When estimating the outflow of resources associated with fulfilling the liability, an entity shall take into account future events that might affect the outflow of resources. The entity shall develop scenarios that reflect those future events, as well as unbiased estimates of the probability weights for each scenario. However, an entity shall not take into account future events, such as a change in legislation, that would change or discharge the present obligation or create new obligations under the existing liability.

Time ~~value~~ Value of ~~money~~ Money

A50-A54. Entities are not indifferent to the timing of an outflow of resources. Accordingly, the timing of the future outflows of resources is a characteristic of a liability and needs to be encompassed in any measurement of a liability's current value. Failure to reflect the time value of money would mean that

the resulting measurement would not be a faithful representation of the economic burden the liability represents.

[A51-A55.](#) An entity shall determine the estimated outflows of resources by adjusting the estimates of future outflows of resources for the time value of money, using discount rates that reflect the characteristics of the liability. Such rates shall:

- (a) Be consistent with observable current market prices for instruments with outflows of resources whose characteristics are consistent with those of the liability's outflows of resources, in terms of, for example, timing, currency and liquidity.
- (b) Exclude the effect of any factors that influence the observable market prices but that are not relevant to the outflows of resources of the liability.

[A52-A56.](#) When using a risk-free rate, the logical sources of reference rates are high quality bonds, for example, bonds issued by a financially sound government. These instruments should include no or insignificant default risk. They will also typically have a range of maturity dates or durations to match the liability durations. In the event that long-dated bonds are unavailable for liabilities with long durations, such as some decommissioning liabilities, it would be necessary to use extrapolation techniques to estimate the rates.

[A53-A57.](#) Although rates on high quality government bonds will not need to be adjusted for default risk in determining the risk free discount rate, they may need to be adjusted for liquidity risk. Some government bonds are traded in deep and liquid markets enabling bond holders to readily sell them at minimal cost. The rate payable on such bonds is lower than the rate payable on an equivalent illiquid bond. Accordingly, it might be necessary to include a 'premium for illiquidity' in the observed rate for government bonds that are not traded in deep and liquid markets.

## Inputs to ~~valuation~~ Valuation techniques Techniques

### General ~~principles~~ Principles

[A54-A58.](#) **Valuation techniques used in a cost of fulfillment measurement shall maximize the use of relevant observable inputs and minimize the use of unobservable inputs.**

[A55-A59.](#) The cost of fulfillment measurement is an entity specific valuation. When a valuation technique is applied, an entity shall select inputs that are consistent with the characteristics of the liability (see paragraph [B14B-4413](#)). The technique should maximize the use of observable inputs that are available to a market participant that is making the same valuation as the entity, from the entity's perspective. For example, when measuring the cost to fulfill a decommissioning liability where payments are due in 50 years, an observable market input when discounting the outflow of resources is the government bond rate applicable to the entity.

[A56-A60.](#) In some cases the characteristics of a liability may result in the application of an adjustment (e.g., there is no corresponding bond rate to discount an outflow of resources due in 3.5 years). However, a cost of fulfillment measurement shall not incorporate an adjustment that is inconsistent with the unit of account in the IPSAS that requires or permits the cost of fulfillment measurement.

[A57-A61.](#) When a liability will settle at a future date, the assumptions applied in developing and identifying inputs are based on current market conditions. For example, a decommissioning liability may be expected to settle in 50 years. The payment due on settlement and the associated discount rate are both based on information available at the measurement date.

## Disclosure

~~For liabilities that are measured at cost of fulfillment in the statement of financial position an entity shall disclose information that helps users of its financial statements assess the valuation techniques and inputs used to develop those measurements.~~

~~To meet the objectives in paragraph 62, an entity shall consider all the following:~~

~~The level of detail necessary to satisfy the disclosure requirements;~~

~~How much emphasis to place on each of the various requirements;~~

~~How much aggregation or disaggregation to undertake; and~~

~~Whether users of financial statements need additional information to evaluate the quantitative information disclosed.~~

~~If the disclosures provided in accordance with this IPSAS and other IPSASs are insufficient to meet the objectives in paragraph 62, an entity shall disclose additional information necessary to meet those objectives.~~

~~To meet the objectives in paragraph 62, an entity shall disclose, at a minimum, the following information for each class of liabilities measured at cost of fulfillment in the statement of financial position after initial recognition:~~

~~A description of the valuation technique(s) used in the cost of fulfillment measurement. If there has been a change in valuation technique, the entity shall disclose that change and the reason(s) for making it.~~

~~The significant assumptions and significant inputs applied in estimating the cost of fulfillment measurements. If there has been a change in significant assumptions or significant inputs, the entity shall disclose that change and the reason(s) for making it.~~

~~The sources of the significant assumptions and significant inputs applied in estimating the cost of fulfillment measurements.~~

~~The timing of significant future outflows of resources that will be applied in settling the obligation measured using the cost of fulfillment.~~

~~The amount of the total gains or losses for the period included in surplus or deficit that is attributable to the change in unrealized gains or losses relating to those liabilities held at the end of the reporting period, and the line item(s) in surplus or deficit in which those unrealized gains or losses are recognized.~~

~~A narrative description of the sensitivity of the cost of fulfillment measurement to changes in significant inputs if a change in those inputs to a different amount might result in a significantly higher or lower cost of fulfillment measurement.~~

**Appendix ~~CB~~: Fair value—application guidance**

*This Appendix is an integral part of [\[draft\] IPSAS \[X\] \(ED XX\)](#), ~~IPSAS XX~~, Measurement.*

**Measurement**

Paragraph ~~B-1~~ is IFRS 13.~~AG2B2~~

- B1. The objective of a fair value measurement is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. A fair value measurement requires an entity to determine all the following:
- (a) The particular asset or liability that is the subject of the measurement (consistently with its unit of account).
  - (b) For a non-financial asset, the valuation premise that is appropriate for the measurement (consistently with its highest and best use).
  - (c) The principal (or most advantageous) market for the asset or liability.
  - (d) The valuation technique(s) appropriate for the measurement, considering the availability of data with which to develop inputs that represent the assumptions that market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorized.

**The ~~asset~~ Asset or Liability**

- B2. A fair value measurement is for a particular asset or liability. Therefore, when measuring fair value an entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Such characteristics include, for example, the following:
- (a) **The condition and location of the asset; and**
  - (b) **Restrictions, if any, on the sale or use of the asset.**
- B3. The effect on the measurement arising from a particular characteristic will differ depending on how that characteristic would be taken into account by market participants.
- B4. The asset or liability measured at fair value might be either of the following:
- (a) A stand-alone asset or liability (e.g., a financial instrument or a non-financial asset); or
  - (b) A group of assets, a group of liabilities or a group of assets and liabilities (e.g., a cash-generating unit or an operation).
- B5. Whether the asset or liability is a stand-alone asset or liability, a group of assets, a group of liabilities or a group of assets and liabilities for recognition or disclosure purposes depends on its *unit of account*. The unit of account for the asset or liability shall be determined in accordance with the IPSAS that requires or permits the fair value measurement, except as provided in this Application Guidance.

**The ~~transaction~~Transaction**

- B6. **A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions.**
- B7. **A fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:**
- (a) In the principal market for the asset or liability; or**
  - (b) In the absence of a principal market, in the most advantageous market for the asset or liability.**
- B8. An entity need not undertake an exhaustive search of all possible markets to identify the principal market or, in the absence of a principal market, the most advantageous market, but it shall take into account all information that is reasonably available. In the absence of evidence to the contrary, the market in which the entity would normally enter into a transaction to sell the asset or to transfer the liability is presumed to be the principal market or, in the absence of a principal market, the most advantageous market.
- B9. If there is a principal market for the asset or liability, the fair value measurement shall represent the price in that market (whether that price is directly observable or estimated using another valuation technique), even if the price in a different market is potentially more advantageous at the measurement date.
- B10. The entity must have access to the principal (or most advantageous) market at the measurement date. Because different entities (and operations within those entities) with different activities may have access to different markets, the principal (or most advantageous) market for the same asset or liability might be different for different entities (and operations within those entities). Therefore, the principal (or most advantageous) market (and thus, market participants) shall be considered from the perspective of the entity, thereby allowing for differences between and among entities with different activities.
- B11. Although an entity must be able to access the market, the entity does not need to be able to sell the particular asset or transfer the particular liability on the measurement date to be able to measure fair value on the basis of the price in that market.
- B12. Even when there is no observable market to provide pricing information about the sale of an asset or the transfer of a liability at the measurement date, a fair value measurement shall assume that a transaction takes place at that date, considered from the perspective of a market participant that holds the asset or owes the liability. That assumed transaction establishes a basis for estimating the price to sell the asset or to transfer the liability.

**Market ~~participants~~Participants**

- B13. **An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.**
- B14. In developing those assumptions, an entity need not identify specific market participants. Rather, the entity shall identify characteristics that distinguish market participants generally, considering factors specific to all the following:

- (a) The asset or liability;
- (b) The principal (or most advantageous) market for the asset or liability; and
- (c) Market participants with whom the entity would enter into a transaction in that market.

### The ~~price~~Price

- B15. **Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e., an exit price) regardless of whether that price is directly observable or estimated using another valuation technique.**
- B16. The price in the principal (or most advantageous) market used to measure the fair value of the asset or liability shall not be adjusted for *transaction costs*. Transaction costs shall be accounted for in accordance with other IPSASs. Transaction costs are not a characteristic of an asset or a liability; rather, they are specific to a transaction and will differ depending on how an entity enters into a transaction for the asset or liability.
- B17. Transaction costs do not include *transport costs*. If location is a characteristic of the asset (as might be the case, for example, for a commodity), the price in the principal (or most advantageous) market shall be adjusted for the costs, if any, that would be incurred to transport the asset from its current location to that market.

### Fair ~~value~~Value at ~~initial~~Initial ~~recognition~~Recognition

- B18. When an asset is acquired or a liability is assumed in an exchange transaction for that asset or liability, the transaction price is the price paid to acquire the asset or received to assume the liability (an *entry price*). In contrast, the fair value of the asset or liability is the price that would be received to sell the asset or paid to transfer the liability (an exit price). Entities do not necessarily sell assets at the prices paid to acquire them. Similarly, entities do not necessarily transfer liabilities at the prices received to assume them.
- B19. In many cases the transaction price will equal the fair value (e.g., that might be the case when on the transaction date the transaction to buy an asset takes place in the market in which the asset would be sold).
- B20. When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. Paragraph ~~B22~~~~B22~~AG4 describes situations in which the transaction price might not represent the fair value of an asset or a liability at initial recognition.
- B21. If another IPSAS requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the entity shall recognize the resulting gain or loss in surplus or deficit unless that IPSAS specifies otherwise.

Paragraph ~~B22~~ is IFRS 13.~~AG4~~B4

- B22. When determining whether fair value at initial recognition equals the transaction price, an entity shall take into account factors specific to the transaction and to the asset or liability. For example, the transaction price might not represent the fair value of an asset or a liability at initial recognition if any of the following conditions exist:

- (a) The transaction is between related parties, although the price in a related party transaction may be used as an input into a fair value measurement if the entity has evidence that the transaction was entered into at market terms.
- (b) The transaction takes place under duress or the seller is forced to accept the price in the transaction. For example, that might be the case if the seller is experiencing financial difficulty.
- (c) The unit of account represented by the transaction price is different from the unit of account for the asset or liability measured at fair value. For example, that might be the case if the asset or liability measured at fair value is only one of the elements in the transaction (e.g., in a public sector combination), the transaction includes unstated rights and privileges that are measured separately in accordance with another IPSAS, or the transaction price includes transaction costs.
- (d) The market in which the transaction takes place is different from the principal market (or most advantageous market). For example, those markets might be different if the entity is a dealer that enters into transactions with customers in the retail market, but the principal (or most advantageous) market for the exit transaction is with other dealers in the dealer market.

### Valuation ~~techniques~~ Techniques

- B23. An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.**
- B24. The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. Three widely used valuation techniques are the market approach, the cost approach and the income approach. The main aspects of those approaches are summarized in paragraphs ~~B29B2929~~–~~B35B3535~~. An entity shall use valuation techniques consistent with one or more of those approaches to measure fair value.
- B25. In some cases a single valuation technique will be appropriate (e.g., when valuing an asset or a liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate (e.g., that might be the case when valuing a cash-generating unit). If multiple valuation techniques are used to measure fair value, the results (i.e., respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A fair value measurement is the point within that range that is most representative of fair value in the circumstances.
- B26. If the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be calibrated so that at initial recognition the result of the valuation technique equals the transaction price. Calibration ensures that the valuation technique reflects current market conditions, and it helps an entity to determine whether an adjustment to the valuation technique is necessary (e.g., there might be a characteristic of the asset or liability that is not captured by the valuation technique). After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, an entity shall ensure that those valuation techniques reflect observable market data (e.g., the price for a similar asset or liability) at the measurement date.
- B27. Valuation techniques used to measure fair value shall be applied consistently. However, a change in a valuation technique or its application (e.g., a change in its weighting when multiple valuation

techniques are used or a change in an adjustment applied to a valuation technique) is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. That might be the case if, for example, any of the following events take place:

- (a) New markets develop;
- (b) New information becomes available;
- (c) Information previously used is no longer available;
- (d) Valuation techniques improve; or
- (e) Market conditions change.

B28. Revisions resulting from a change in the valuation technique or its application shall be accounted for as a change in accounting estimate in accordance with IPSAS 3. However, the disclosures in IPSAS 3 for a change in accounting estimate are not required for revisions resulting from a change in a valuation technique or its application.

#### Market ~~approach~~ Approach

Paragraphs [B-29](#)-[B-31](#) are IFRS 13. [AG5B5-AG7B7](#)

B29. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (i.e., similar) assets, liabilities or a group of assets and liabilities, such as an operation.

B30. For example, valuation techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might be in ranges with a different multiple for each comparable. The selection of the appropriate multiple within the range requires judgement, considering qualitative and quantitative factors specific to the measurement.

B31. Valuation techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique used principally to value some types of financial instruments, such as debt securities, without relying exclusively on quoted prices for the specific securities, but rather relying on the securities' relationship to other benchmark quoted securities.

#### Cost ~~approach~~ Approach

Paragraphs [B-32](#) and [B-33](#) are IFRS 13. [AG8-B8](#) and [AG9B9](#)

B32. The cost approach reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).

B33. From the perspective of a market participant seller, the price that would be received for the asset is based on the cost to a market participant buyer to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence. That is because a market participant buyer would not pay more for an asset than the amount for which it could replace the service capacity of that asset. Obsolescence encompasses physical deterioration, functional (technological) obsolescence and economic (external) obsolescence and is broader than depreciation for financial reporting purposes (an allocation of historical cost) or tax purposes (using specified service lives). In many cases the current replacement cost method is used to measure the fair value of tangible assets that are used in combination with other assets or with other assets and liabilities.

*Income ~~approach~~ Approach*

Paragraphs ~~B-34~~ and ~~B-35~~ are IFRS 13. ~~AG10-B10~~ and ~~AG11-B11~~

B34. The income approach converts future amounts (e.g., cash flows or income and expenses) to a single current (i.e., discounted) amount. When the income approach is used, the fair value measurement reflects current market expectations about those future amounts.

B35. Those valuation techniques include, for example, the following:

- (a) Present value techniques (see paragraphs ~~B36B3636~~–~~B55B5554~~);
- (b) Option pricing models, such as the Black-Scholes-Merton formula or a binomial model (i.e., a lattice model), that incorporate present value techniques and reflect both the time value and the intrinsic value of an option; and
- (c) The multi-period excess earnings method, which is used to measure the fair value of some intangible assets.

*Present ~~value~~ Value techniques Techniques*

Paragraphs ~~B-36~~ and ~~B-37~~ are IFRS 13. ~~AG12-B12~~ and ~~AG13B13~~

B36. Paragraphs 37–54 describe the use of present value techniques to measure fair value. Those paragraphs focus on a discount rate adjustment technique and an expected cash flow (expected present value) technique. Those paragraphs neither prescribe the use of a single specific present value technique nor limit the use of present value techniques to measure fair value to the techniques discussed. The present value technique used to measure fair value will depend on facts and circumstances specific to the asset or liability being measured (e.g., whether prices for comparable assets or liabilities can be observed in the market) and the availability of sufficient data.

The ~~components~~ Components of a ~~present~~ Present value Value measurement Measurement

B37. Present value (i.e., an application of the income approach) is a tool used to link future amounts (e.g., cash flows or values) to a present amount using a discount rate. A fair value measurement of an asset or a liability using a present value technique captures all the following elements from the perspective of market participants at the measurement date:

- (a) An estimate of future cash flows for the asset or liability being measured.
- (b) Expectations about possible variations in the amount and timing of the cash flows representing the uncertainty inherent in the cash flows.
- (c) The time value of money, represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default to the holder (i.e., a risk-free interest rate).
- (d) The price for bearing the uncertainty inherent in the cash flows (i.e., a risk premium).
- (e) Other factors that market participants would take into account in the circumstances.
- (f) For a liability, the non-performance risk relating to that liability, including the entity's (i.e., the obligor's) own credit risk.

*General ~~P~~Principles*

Paragraph ~~B~~-38 is IFRS 13. ~~AG14~~B14

- B38. Present value techniques differ in how they capture the elements in paragraph ~~B37~~B37. However, all the following general principles govern the application of any present value technique used to measure fair value:
- (a) Cash flows and discount rates should reflect assumptions that market participants would use when pricing the asset or liability.
  - (b) Cash flows and discount rates should take into account only the factors attributable to the asset or liability being measured.
  - (c) To avoid double-counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the cash flows. For example, a discount rate that reflects the uncertainty in expectations about future defaults is appropriate if using contractual cash flows of a loan (i.e., a discount rate adjustment technique). That same rate should not be used if using expected (i.e., probability-weighted) cash flows (i.e., an expected present value technique) because the expected cash flows already reflect assumptions about the uncertainty in future defaults; instead, a discount rate that is commensurate with the risk inherent in the expected cash flows should be used.
  - (d) Assumptions about cash flows and discount rates should be internally consistent. For example, nominal cash flows, which include the effect of inflation, should be discounted at a rate that includes the effect of inflation. The nominal risk-free interest rate includes the effect of inflation. Real cash flows, which exclude the effect of inflation, should be discounted at a rate that excludes the effect of inflation. Similarly, after-tax cash flows should be discounted using an after-tax discount rate. Pre-tax cash flows should be discounted at a rate consistent with those cash flows.
  - (e) Discount rates should be consistent with the underlying economic factors of the currency in which the cash flows are denominated.

*Risk and ~~uncertainty~~Uncertainty*

Paragraphs ~~B~~-39-~~B~~-41 are IFRS 13. ~~AG15~~B15-~~AG17~~B17

- B39. A fair value measurement using present value techniques is made under conditions of uncertainty because the cash flows used are estimates rather than known amounts. In many cases both the amount and timing of the cash flows are uncertain. Even contractually fixed amounts, such as the payments on a loan, are uncertain if there is risk of default.
- B40. Market participants generally seek compensation (i.e., a risk premium) for bearing the uncertainty inherent in the cash flows of an asset or a liability. A fair value measurement should include a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows. Otherwise, the measurement would not faithfully represent fair value. 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.
- B41. Present value techniques differ in how they adjust for risk and in the type of cash flows they use. For example:

- (a) The discount rate adjustment technique (see paragraphs [B42B4242-B46B4646](#)) uses a risk-adjusted discount rate and contractual, promised or most likely cash flows.
- (b) Method 1 of the expected present value technique (see paragraph [B49B4949](#)) uses risk-adjusted expected cash flows and a risk-free rate.
- (c) Method 2 of the expected present value technique (see paragraph [B50B5050](#)) uses expected cash flows that are not risk-adjusted and a discount rate adjusted to include the risk premium that market participants require. That rate is different from the rate used in the discount rate adjustment technique.

*Discount rate* *Rate adjustment* *Adjustment technique* *Technique*

Paragraphs [B-42--B-46](#) are IFRS 13.[AG18B18-BAG22](#)

[24-B42.](#) The discount rate adjustment technique uses a single set of cash flows from the range of possible estimated amounts, whether contractual or promised (as is the case for a bond) or most likely cash flows. In all cases, those cash flows are conditional upon the occurrence of specified events (e.g., contractual or promised cash flows for a bond are conditional on the event of no default by the debtor). The discount rate used in the discount rate adjustment technique is derived from observed rates of return for comparable assets or liabilities that are traded in the market. Accordingly, the contractual, promised or most likely cash flows are discounted at an observed or estimated market rate for such conditional cash flows (i.e., a market rate of return).

[25-B43.](#) The discount rate adjustment technique requires an analysis of market data for comparable assets or liabilities. Comparability is established by considering the nature of the cash flows (e.g., whether the cash flows are contractual or non-contractual and are likely to respond similarly to changes in economic conditions), as well as other factors (e.g., credit standing, collateral, duration, restrictive covenants and liquidity). Alternatively, if a single comparable asset or liability does not fairly reflect the risk inherent in the cash flows of the asset or liability being measured, it may be possible to derive a discount rate using data for several comparable assets or liabilities in conjunction with the risk-free yield curve (i.e., using a 'build-up' approach).

[26-B44.](#) To illustrate a build-up approach, assume that Asset A is a contractual right to receive CU800 in one year (i.e., there is no timing uncertainty). There is an established market for comparable assets, and information about those assets, including price information, is available. Of those comparable assets:

- (a) Asset B is a contractual right to receive CU1,200 in one year and has a market price of CU1,083. Thus, the implied annual rate of return (i.e., a one-year market rate of return) is 10.8 per cent  $[(CU1,200/CU1,083) - 1]$ .
- (b) Asset C is a contractual right to receive CU700 in two years and has a market price of CU566. Thus, the implied annual rate of return (i.e., a two-year market rate of return) is 11.2 per cent  $[(CU700/CU566)^{0.5} - 1]$ .
- (c) All three assets are comparable with respect to risk (i.e., dispersion of possible pay-offs and credit).

[27-B45.](#) On the basis of the timing of the contractual payments to be received for Asset A relative to the timing for Asset B and Asset C (i.e., one year for Asset B versus two years for Asset C), Asset B is deemed more comparable to Asset A. Using the contractual payment to be received for Asset A (CU800) and the one-year market rate derived from Asset B (10.8 per cent), the fair value of Asset

A is CU722 (CU800/1.108). Alternatively, in the absence of available market information for Asset B, the one-year market rate could be derived from Asset C using the build-up approach. In that case the two-year market rate indicated by Asset C (11.2 per cent) would be adjusted to a one-year market rate using the term structure of the risk-free yield curve. Additional information and analysis might be required to determine whether the risk premiums for one-year and two-year assets are the same. If it is determined that the risk premiums for one-year and two-year assets are not the same, the two-year market rate of return would be further adjusted for that effect.

~~28-B46.~~ When the discount rate adjustment technique is applied to fixed receipts or payments, the adjustment for risk inherent in the cash flows of the asset or liability being measured is included in the discount rate. In some applications of the discount rate adjustment technique to cash flows that are not fixed receipts or payments, an adjustment to the cash flows may be necessary to achieve comparability with the observed asset or liability from which the discount rate is derived.

Expected ~~present value~~ *Value technique* *Technique*

Paragraphs ~~B47-B54~~ are IFRS 13.AG23-AG30

~~29-B47.~~ The expected present value technique uses as a starting point a set of cash flows that represents the probability-weighted average of all possible future cash flows (i.e., the expected cash flows). The resulting estimate is identical to expected value, which, in statistical terms, is the weighted average of a discrete random variable's possible values with the respective probabilities as the weights. Because all possible cash flows are probability-weighted, the resulting expected cash flow is not conditional upon the occurrence of any specified event (unlike the cash flows used in the discount rate adjustment technique).

~~30-B48.~~ In making an investment decision, risk-averse market participants would take into account the risk that the actual cash flows may differ from the expected cash flows. Portfolio theory distinguishes between two types of risk:

- (a) Unsystematic (diversifiable) risk, which is the risk specific to a particular asset or liability.
- (b) Systematic (non-diversifiable) risk, which is the common risk shared by an asset or a liability with the other items in a diversified portfolio.

Portfolio theory holds that in a market in equilibrium, market participants will be compensated only for bearing the systematic risk inherent in the cash flows. (In markets that are inefficient or out of equilibrium, other forms of return or compensation might be available.)

~~31-B49.~~ Method 1 of the expected present value technique adjusts the expected cash flows of an asset for systematic (i.e., market) risk by subtracting a cash risk premium (i.e., risk-adjusted expected cash flows). Those risk-adjusted expected cash flows represent a certainty-equivalent cash flow, which is discounted at a risk-free interest rate. A certainty-equivalent cash flow refers to an expected cash flow (as defined), adjusted for risk so that a market participant is indifferent to trading a certain cash flow for an expected cash flow. For example, if a market participant was willing to trade an expected cash flow of CU1,200 for a certain cash flow of CU1,000, the CU1,000 is the certainty equivalent of the CU1,200 (i.e., the CU200 would represent the cash risk premium). In that case the market participant would be indifferent as to the asset held.

~~32-B50.~~ In contrast, Method 2 of the expected present value technique adjusts for systematic (i.e., market) risk by applying a risk premium to the risk-free interest rate. Accordingly, the expected cash flows are discounted at a rate that corresponds to an expected rate associated with probability-

weighted cash flows (i.e., an expected rate of return). Models used for pricing risky assets, such as the capital asset pricing model, can be used to estimate the expected rate of return. Because the discount rate used in the discount rate adjustment technique is a rate of return relating to conditional cash flows, it is likely to be higher than the discount rate used in Method 2 of the expected present value technique, which is an expected rate of return relating to expected or probability-weighted cash flows.

**33-B51.** To illustrate Methods 1 and 2, assume that an asset has expected cash flows of CU780 in one year determined on the basis of the possible cash flows and probabilities shown below. The applicable risk-free interest rate for cash flows with a one-year horizon is 5 per cent, and the systematic risk premium for an asset with the same risk profile is 3 per cent.

Possible cash flows	Probability	Probability-weighted cash flows
CU500	15%	CU75
CU800	60%	CU480
CU900	25%	CU225
Expected cash flows		CU780

**34-B52.** In this simple illustration, the expected cash flows (CU780) represent the probability-weighted average of the three possible outcomes. In more realistic situations, there could be many possible outcomes. However, to apply the expected present value technique, it is not always necessary to take into account distributions of all possible cash flows using complex models and techniques. Rather, it might be possible to develop a limited number of discrete scenarios and probabilities that capture the array of possible cash flows. For example, an entity might use realized cash flows for some relevant past period, adjusted for changes in circumstances occurring subsequently (e.g., changes in external factors, including economic or market conditions, industry trends and competition as well as changes in internal factors affecting the entity more specifically), taking into account the assumptions of market participants.

**35-B53.** In theory, the present value (i.e., the fair value) of the asset's cash flows is the same whether determined using Method 1 or Method 2, as follows:

- (a) Using Method 1, the expected cash flows are adjusted for systematic (i.e., market) risk. In the absence of market data directly indicating the amount of the risk adjustment, such adjustment could be derived from an asset pricing model using the concept of certainty equivalents. For example, the risk adjustment (i.e., the cash risk premium of CU22) could be determined using the systematic risk premium of 3 per cent ( $CU780 - [CU780 \times (1.05/1.08)]$ ), which results in risk-adjusted expected cash flows of CU758 ( $CU780 - CU22$ ). The CU758 is the certainty equivalent of CU780 and is discounted at the risk-free interest rate (5 per cent). The present value (i.e., the fair value) of the asset is CU722 ( $CU758/1.05$ ).
- (b) Using Method 2, the expected cash flows are not adjusted for systematic (i.e., market) risk. Rather, the adjustment for that risk is included in the discount rate. Thus, the expected cash flows are discounted at an expected rate of return of 8 per cent (i.e., the 5 per cent risk-free interest rate plus the 3 per cent systematic risk premium). The present value (i.e., the fair value) of the asset is CU722 ( $CU780/1.08$ ).

~~36-B54.~~ When using an expected present value technique to measure fair value, either Method 1 or Method 2 could be used. The selection of Method 1 or Method 2 will depend on facts and circumstances specific to the asset or liability being measured, the extent to which sufficient data are available and the judgements applied.

### Inputs to ~~valuation~~ Valuation techniques Techniques

#### General ~~principles~~ Principles

~~37-B55.~~ **Valuation techniques used to measure fair value shall maximize the use of relevant observable inputs and minimize the use of unobservable inputs.**

~~38-B56.~~ Examples of markets in which inputs might be observable for some assets and liabilities (e.g., financial instruments) include exchange markets, dealer markets, brokered markets and principal-to-principal markets (see paragraph ~~B57~~ B57).

Paragraph ~~B-57~~ is IFRS 13. AG34 B34

~~39-B57.~~ Examples of markets in which inputs might be observable for some assets and liabilities (e.g., financial instruments) include the following:

- (a) Exchange markets. In an exchange market, closing prices are both readily available and generally representative of fair value. An example of such a market is the London Stock Exchange.
- (b) Dealer markets. In a dealer market, dealers stand ready to trade (either buy or sell for their own account), thereby providing liquidity by using their capital to hold an inventory of the items for which they make a market. Typically bid and ask prices (representing the price at which the dealer is willing to buy and the price at which the dealer is willing to sell, respectively) are more readily available than closing prices. Over-the-counter markets (for which prices are publicly reported) are dealer markets. Dealer markets also exist for some other assets and liabilities, including some financial instruments, commodities and physical assets (e.g., used equipment).
- (c) Brokered markets. In a brokered market, brokers attempt to match buyers with sellers but do not stand ready to trade for their own account. In other words, brokers do not use their own capital to hold an inventory of the items for which they make a market. The broker knows the prices bid and asked by the respective parties, but each party is typically unaware of another party's price requirements. Prices of completed transactions are sometimes available. Brokered markets include electronic communication networks, in which buy and sell orders are matched, and commercial and residential real estate markets.
- (d) Principal-to-principal markets. In a principal-to-principal market, transactions, both originations and resales, are negotiated independently with no intermediary. Little information about those transactions may be made available publicly.

~~40-B58.~~ An entity shall select inputs that are consistent with the characteristics of the asset or liability that market participants would take into account in a transaction for the asset or liability (see paragraphs ~~B2B22~~ B2B22 and ~~B3B33~~ B3B33). In some cases those characteristics result in the application of an adjustment, such as a premium or discount (e.g., a control premium or non-controlling interest discount). However, a fair value measurement shall not incorporate a premium or discount that is inconsistent with the unit of account in the IPSAS that requires or permits the fair value measurement

(see paragraphs [B4B40](#) and [B5B57](#)). Premiums or discounts that reflect size as a characteristic of the entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity, as described in paragraph [B67B6767](#)) rather than as a characteristic of the asset or liability (e.g., a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement. In all cases, if there is a quoted price in an active market (i.e., a Level 1 input) for an asset or a liability, an entity shall use that price without adjustment when measuring fair value, except as specified in paragraph [B66B6666](#).

### **Fair value-Value hierarchyHierarchy**

[41-B59](#). To increase consistency and comparability in fair value measurements and related disclosures, this Application Guidance establishes a fair value hierarchy that categorizes into three levels (see paragraphs [B63B6363](#)–[B90B9090](#)) the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

[42-B60](#). In some cases, the inputs used to measure the fair value of an asset or a liability might be categorized within different levels of the fair value hierarchy. In those cases, the fair value measurement is categorized in its entirety in the same level of the fair value hierarchy as the lowest level input that is significant to the entire measurement. Assessing the significance of a particular input to the entire measurement requires judgement, taking into account factors specific to the asset or liability. Adjustments to arrive at measurements based on fair value, such as costs to sell when measuring fair value less costs to sell, shall not be taken into account when determining the level of the fair value hierarchy within which a fair value measurement is categorized.

[43-B61](#). The availability of relevant inputs and their relative subjectivity might affect the selection of appropriate valuation techniques (see paragraph [B23B2323](#)). However, the fair value hierarchy prioritizes the inputs to valuation techniques, not the valuation techniques used to measure fair value. For example, a fair value measurement developed using a present value technique might be categorized within Level 2 or Level 3, depending on the inputs that are significant to the entire measurement and the level of the fair value hierarchy within which those inputs are categorized.

[44-B62](#). If an observable input requires an adjustment using an unobservable input and that adjustment results in a significantly higher or lower fair value measurement, the resulting measurement would be categorized within Level 3 of the fair value hierarchy. For example, if a market participant would take into account the effect of a restriction on the sale of an asset when estimating the price for the asset, an entity would adjust the quoted price to reflect the effect of that restriction. If that quoted price is a Level 2 input and the adjustment is an unobservable input that is significant to the entire measurement, the measurement would be categorized within Level 3 of the fair value hierarchy.

### **Level 1 ~~inputs~~Inputs**

[45-B63](#). Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

[46-B64](#). A quoted price in an active market provides the most faithfully representative evidence of fair value and shall be used without adjustment to measure fair value whenever available, except as specified in paragraph [B66B6666](#).

47-B65. A Level 1 input will be available for many financial assets and financial liabilities, some of which might be exchanged in multiple active markets (e.g., on different exchanges). Therefore, the emphasis within Level 1 is on determining both of the following:

- (a) The principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability; and
- (b) Whether the entity can enter into a transaction for the asset or liability at the price in that market at the measurement date.

48-B66. An entity shall not make an adjustment to a Level 1 input except in the following circumstances:

- (a) When an entity holds a large number of similar (but not identical) assets or liabilities (e.g., debt securities) that are measured at fair value and a quoted price in an active market is available but not readily accessible for each of those assets or liabilities individually (i.e., given the large number of similar assets or liabilities held by the entity, it would be difficult to obtain pricing information for each individual asset or liability at the measurement date). In that case, as a practical expedient, an entity may measure fair value using an alternative pricing method that does not rely exclusively on quoted prices (e.g., matrix pricing). However, the use of an alternative pricing method results in a fair value measurement categorized within a lower level of the fair value hierarchy.
- (b) When a quoted price in an active market does not represent fair value at the measurement date. That might be the case if, for example, significant events (such as transactions in a principal-to-principal market, trades in a brokered market or announcements) take place after the close of a market but before the measurement date. An entity shall establish and consistently apply a policy for identifying those events that might affect fair value measurements. However, if the quoted price is adjusted for new information, the adjustment results in a fair value measurement categorized within a lower level of the fair value hierarchy.
- (c) When measuring the fair value of a liability or an entity's own equity instrument using the quoted price for the identical item traded as an asset in an active market and that price needs to be adjusted for factors specific to the item or the asset (see paragraph xx of IPSAS 41). If no adjustment to the quoted price of the asset is required, the result is a fair value measurement categorized within Level 1 of the fair value hierarchy. However, any adjustment to the quoted price of the asset results in a fair value measurement categorized within a lower level of the fair value hierarchy.

49-B67. If an entity holds a position in a single asset or liability (including a position comprising a large number of identical assets or liabilities, such as a holding of financial instruments) and the asset or liability is traded in an active market, the fair value of the asset or liability shall be measured within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held by the entity. That is the case even if a market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

#### Level 2 ~~inputs~~Inputs

50-B68. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

[51-B69.](#) If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

- (a) Quoted prices for similar assets or liabilities in active markets.
- (b) Quoted prices for identical or similar assets or liabilities in markets that are not active.
- (c) inputs other than quoted prices that are observable for the asset or liability, for example:
  - (i) Interest rates and yield curves observable at commonly quoted intervals;
  - (ii) Implied volatilities; and
  - (iii) Credit spreads.
- (d) Market-corroborated inputs.

[52-B70.](#) Adjustments to Level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the following:

- (a) The condition or location of the asset;
- (b) The extent to which inputs relate to items that are comparable to the asset or liability (including those factors described in paragraph xx of IPSAS 41; and
- (c) The volume or level of activity in the markets within which the inputs are observed.

[53-B71.](#) An adjustment to a Level 2 input that is significant to the entire measurement might result in a fair value measurement categorized within Level 3 of the fair value hierarchy if the adjustment uses significant unobservable inputs.

[54-B72.](#) Paragraph [B73B73](#) describes the use of Level 2 inputs for particular assets and liabilities.

Paragraph [B-73](#) is IFRS 13.[AG35B35](#)

[55-B73.](#) Examples of Level 2 inputs for particular assets and liabilities include the following:

- (a) Licensing arrangement. For a licensing arrangement that is acquired in a public sector combination and was recently negotiated with an unrelated party by the acquired entity (the party to the licensing arrangement), a Level 2 input would be the royalty rate in the contract with the unrelated party at inception of the arrangement.
- (b) Finished goods inventory at a retail outlet. For finished goods inventory that is acquired in a public sector combination, a Level 2 input would be either a price to customers in a retail market or a price to retailers in a wholesale market, adjusted for differences between the condition and location of the inventory item and the comparable (i.e., similar) inventory items so that the fair value measurement reflects the price that would be received in a transaction to sell the inventory to another retailer that would complete the requisite selling efforts. Conceptually, the fair value measurement will be the same, whether adjustments are made to a retail price (downward) or to a wholesale price (upward). Generally, the price that requires the least amount of subjective adjustments should be used for the fair value measurement.
- (c) Building held and used. A Level 2 input would be the price per square meter for the building (a valuation multiple) derived from observable market data, e.g., multiples derived from prices in observed transactions involving comparable (i.e., similar) buildings in similar locations.
- (d) Cash-generating unit. A Level 2 input would be a valuation multiple (e.g., a multiple of earnings or revenue or a similar performance measure) derived from observable market data, e.g.,

multiples derived from prices in observed transactions involving comparable (i.e., similar) operations, taking into account operational, market, financial and non-financial factors.

### *Level 3 inputs*

~~56-B74.~~ Level 3 inputs are unobservable inputs for the asset or liability.

~~57-B75.~~ Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, i.e., an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk.

~~58-B76.~~ Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique. A measurement that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one when pricing the asset or liability. For example, it might be necessary to include a risk adjustment when there is significant measurement uncertainty (e.g., when there has been a significant decrease in the volume or level of activity when compared with normal market activity for the asset or liability, or similar assets or liabilities, and the entity has determined that the transaction price or quoted price does not represent fair value, as described in paragraphs ~~B77-B7777-B87B8787~~).

### *Measuring fair value when the volume or level of activity for an asset or a liability has significantly decreased*

Paragraphs ~~B77B77-B87B8777-87~~ are IFRS 13.~~AG37B37-AG47B47~~

~~59-B77.~~ The fair value of an asset or a liability might be affected when there has been a significant decrease in the volume or level of activity for that asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). To determine whether, on the basis of the evidence available, there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate the significance and relevance of factors such as the following:

- (a) There are few recent transactions.
- (b) Price quotations are not developed using current information.
- (c) Price quotations vary substantially either over time or among market-makers (e.g., some brokered markets).
- (d) Indices that previously were highly correlated with the fair values of the asset or liability are demonstrably uncorrelated with recent indications of fair value for that asset or liability.
- (e) There is a significant increase in implied liquidity risk premiums, yields or performance indicators (such as delinquency rates or loss severities) for observed transactions or quoted prices when compared with the entity's estimate of expected cash flows, taking into account all available market data about credit and other non-performance risk for the asset or liability.
- (f) There is a wide bid-ask spread or significant increase in the bid-ask spread.

- (g) There is a significant decline in the activity of, or there is an absence of, a market for new issues (i.e., a primary market) for the asset or liability or similar assets or liabilities.
- (h) Little information is publicly available (e.g., for transactions that take place in a principal-to-principal market).

~~60-B78.~~ If an entity concludes that there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities), further analysis of the transactions or quoted prices is needed. A decrease in the volume or level of activity on its own may not indicate that a transaction price or quoted price does not represent fair value or that a transaction in that market is not orderly. However, if an entity determines that a transaction or quoted price does not represent fair value (e.g., there may be transactions that are not orderly), an adjustment to the transactions or quoted prices will be necessary if the entity uses those prices as a basis for measuring fair value and that adjustment may be significant to the fair value measurement in its entirety. Adjustments also may be necessary in other circumstances (e.g., when a price for a similar asset requires significant adjustment to make it comparable to the asset being measured or when the price is stale).

~~61-B79.~~ This Application Guidance does not prescribe a methodology for making significant adjustments to transactions or quoted prices. See paragraphs ~~B23B2323–B28B2828~~ and ~~B29B2929–B35B3535~~ for a discussion of the use of valuation techniques when measuring fair value. Regardless of the valuation technique used, an entity shall include appropriate risk adjustments, including a risk premium reflecting the amount that market participants would demand as compensation for the uncertainty inherent in the cash flows of an asset or a liability (see paragraph ~~B41B4144~~). Otherwise, the measurement does not faithfully represent fair value. In some cases determining the appropriate risk adjustment might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment. The risk adjustment shall be reflective of an orderly transaction between market participants at the measurement date under current market conditions.

~~62-B80.~~ If there has been a significant decrease in the volume or level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate (e.g., the use of a market approach and a present value technique). When weighting indications of fair value resulting from the use of multiple valuation techniques, an entity shall consider the reasonableness of the range of fair value measurements. The objective is to determine the point within the range that is most representative of fair value under current market conditions. A wide range of fair value measurements may be an indication that further analysis is needed.

~~63-B81.~~ Even when there has been a significant decrease in the volume or level of activity for the asset or liability, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (i.e., not a forced liquidation or distress sale) between market participants at the measurement date under current market conditions.

~~64-B82.~~ Estimating the price at which market participants would be willing to enter into a transaction at the measurement date under current market conditions if there has been a significant decrease in the volume or level of activity for the asset or liability depends on the facts and circumstances at the measurement date and requires judgement. 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.

*Identifying ~~transactions~~ Transactions that are not ~~orderly~~ Orderly*

~~65-B83.~~ The determination of whether a transaction is orderly (or is not orderly) is more difficult if there has been a significant decrease in the volume or level of activity for the asset or liability in relation to normal market activity for the asset or liability (or similar assets or liabilities). In such circumstances it is not appropriate to conclude that all transactions in that market are not orderly (i.e., forced liquidations or distress sales). Circumstances that may indicate that a transaction is not orderly include the following:

- (a) There was not adequate exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities under current market conditions.
- (b) There was a usual and customary marketing period, but the seller marketed the asset or liability to a single market participant.
- (c) The seller is in or near bankruptcy or receivership (i.e., the seller is distressed).
- (d) The seller was required to sell to meet regulatory or legal requirements (i.e., the seller was forced).
- (e) The transaction price is an outlier when compared with other recent transactions for the same or a similar asset or liability.

An entity shall evaluate the circumstances to determine whether, on the weight of the evidence available, the transaction is orderly.

~~66-B84.~~ An entity shall consider all the following when measuring fair value or estimating market risk premiums:

- (a) If the evidence indicates that a transaction is not orderly, an entity shall place little, if any, weight (compared with other indications of fair value) on that transaction price.
- (b) If the evidence indicates that a transaction is orderly, an entity shall take into account that transaction price. The amount of weight placed on that transaction price when compared with other indications of fair value will depend on the facts and circumstances, such as the following:
  - (i) The volume of the transaction.
  - (ii) The comparability of the transaction to the asset or liability being measured.
  - (iii) The proximity of the transaction to the measurement date.
- (c) If an entity does not have sufficient information to conclude whether a transaction is orderly, it shall take into account the transaction price. However, that transaction price may not represent fair value (i.e., the transaction price is not necessarily the sole or primary basis for measuring fair value or estimating market risk premiums). When an entity does not have sufficient information to conclude whether particular transactions are orderly, the entity shall place less weight on those transactions when compared with other transactions that are known to be orderly.

An entity need not undertake exhaustive efforts to determine whether a transaction is orderly, but it shall not ignore information that is reasonably available. When an entity is a party to a transaction, it is presumed to have sufficient information to conclude whether the transaction is orderly.

Using ~~quoted~~ Quoted prices/Prices provided/Provided by ~~third~~ Third parties/Parties

67-B85. This Application Guidance does not preclude the use of quoted prices provided by third parties, such as pricing services or brokers, if an entity has determined that the quoted prices provided by those parties are developed in accordance with this Application Guidance.

68-B86. If there has been a significant decrease in the volume or level of activity for the asset or liability, an entity shall evaluate whether the quoted prices provided by third parties are developed using current information that reflects orderly transactions or a valuation technique that reflects market participant assumptions (including assumptions about risk). In weighting a quoted price as an input to a fair value measurement, an entity places less weight (when compared with other indications of fair value that reflect the results of transactions) on quotes that do not reflect the result of transactions.

69-B87. Furthermore, the nature of a quote (e.g., whether the quote is an indicative price or a binding offer) shall be taken into account when weighting the available evidence, with more weight given to quotes provided by third parties that represent binding offers.

70-B88. An entity shall develop unobservable inputs using the best information available in the circumstances, which might include the entity's own data. In developing unobservable inputs, an entity may begin with its own data, but it shall adjust those data if reasonably available information indicates that other market participants would use different data or there is something particular to the entity that is not available to other market participants (e.g., an entity-specific synergy). An entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, an entity shall take into account all information about market participant assumptions that is reasonably available. Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement.

71-B89. Paragraph B90 describes the use of Level 3 inputs for particular assets and liabilities.

Paragraph B-90 is IFRS 13.AG36

72-B90. Examples of Level 3 inputs for particular assets and liabilities include the following:

- (a) Long-dated currency swap. A Level 3 input would be an interest rate in a specified currency that is not observable and cannot be corroborated by observable market data at commonly quoted intervals or otherwise for substantially the full term of the currency swap. The interest rates in a currency swap are the swap rates calculated from the respective countries' yield curves.
- (b) Three-year option on exchange-traded shares. A Level 3 input would be historical volatility, i.e., the volatility for the shares derived from the shares' historical prices. Historical volatility typically does not represent current market participants' expectations about future volatility, even if it is the only information available to price an option.
- (c) Interest rate swap. A Level 3 input would be an adjustment to a mid-market consensus (non-binding) price for the swap developed using data that are not directly observable and cannot otherwise be corroborated by observable market data.
- (d) Decommissioning liability assumed in a public sector combination. A Level 3 input would be a current estimate using the entity's own data about the future cash outflows to be paid to fulfil the obligation (including market participants' expectations about the costs of fulfilling the obligation and the compensation that a market participant would require for taking on the obligation to dismantle the asset) if there is no reasonably available information that indicates

that market participants would use different assumptions. That Level 3 input would be used in a present value technique together with other inputs, e.g., a current risk-free interest rate or a credit-adjusted risk-free rate if the effect of the entity's credit standing on the fair value of the liability is reflected in the discount rate rather than in the estimate of future cash outflows.

- (e) Cash-generating unit. A Level 3 input would be a financial forecast (e.g., of cash) developed using the entity's own data if there is no reasonably available information that indicates that market participants would use different assumptions.

## Disclosure

~~73. An entity shall disclose information that helps users of its financial statements assess both of the following:~~

- ~~(a) For assets and liabilities that are measured at fair value on a recurring or non-recurring basis in the statement of financial position after initial recognition, the valuation techniques and inputs used to develop those measurements.~~
- ~~(b) For recurring fair value measurements using significant unobservable inputs (Level 3), the effect of the measurements on surplus or deficit or net assets/equity for the period.~~

~~74. To meet the objectives in paragraph 91, an entity shall consider all the following:~~

- ~~(a) The level of detail necessary to satisfy the disclosure requirements;~~
- ~~(b) How much emphasis to place on each of the various requirements;~~
- ~~(c) How much aggregation or disaggregation to undertake; and~~
- ~~(d) Whether users of financial statements need additional information to evaluate the quantitative information disclosed.~~

~~If the disclosures provided in accordance with this IPSAS and other IPSASs are insufficient to meet the objectives in paragraph 91, an entity shall disclose additional information necessary to meet those objectives.~~

~~75. To meet the objectives in paragraph 91, an entity shall disclose, at a minimum, the following information for each class of assets and liabilities (see paragraph 94 for information on determining appropriate classes of assets and liabilities) measured at fair value (including measurements based on fair value within the scope of this Application Guidance) in the statement of financial position after initial recognition:~~

- ~~(a) For recurring and non-recurring fair value measurements, the fair value measurement at the end of the reporting period, and for non-recurring fair value measurements, the reasons for the measurement. Recurring fair value measurements of assets or liabilities are those that other IPSASs require or permit in the statement of financial position at the end of each reporting period. Non-recurring fair value measurements of assets or liabilities are those that other IPSASs require or permit in the statement of financial position in particular circumstances (e.g., when an entity measures an asset held for sale at fair value less costs to sell in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* because the asset's fair value less costs to sell is lower than its carrying amount).~~

- ~~(b) For recurring and non-recurring fair value measurements, the level of the fair value hierarchy within which the fair value measurements are in their entirety (Level 1, 2 or 3).~~
- ~~(c) For assets and liabilities held at the end of the reporting period that are measured at fair value on a recurring basis, the amounts of any transfers between Level 1 and Level 2 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred (see paragraph 96). Transfers into each level shall be disclosed and discussed separately from transfers out of each level.~~
- ~~(d) For recurring and non-recurring fair value measurements categorized within Level 2 and Level 3 of the fair value hierarchy, a description of the valuation technique(s) and the inputs used in the fair value measurement. If there has been a change in valuation technique (e.g., changing from a market approach to an income approach or the use of an additional valuation technique), the entity shall disclose that change and the reason(s) for making it. For fair value measurements categorized within Level 3 of the fair value hierarchy, an entity shall provide quantitative information about the significant unobservable inputs used in the fair value measurement. An entity is not required to create quantitative information to comply with this disclosure requirement if quantitative unobservable inputs are not developed by the entity when measuring fair value (e.g., when an entity uses prices from prior transactions or third-party pricing information without adjustment). However, when providing this disclosure an entity cannot ignore quantitative unobservable inputs that are significant to the fair value measurement and are reasonably available to the entity.~~
- ~~(e) For recurring fair value measurements categorized within Level 3 of the fair value hierarchy, a reconciliation from the opening balances to the closing balances, disclosing separately changes during the period attributable to the following:
  - ~~(i) Total gains or losses for the period recognized in surplus or deficit, and the line item(s) in surplus or deficit in which those gains or losses are recognized.~~
  - ~~(ii) Total gains or losses for the period recognized in net assets/equity, and the line item(s) in net assets/equity in which those gains or losses are recognized.~~
  - ~~(iii) Purchases, sales, issues and settlements (each of those types of changes disclosed separately).~~
  - ~~(iv) The amounts of any transfers into or out of Level 3 of the fair value hierarchy, the reasons for those transfers and the entity's policy for determining when transfers between levels are deemed to have occurred (see paragraph 96). Transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.~~~~
- ~~(f) For recurring fair value measurements categorized within Level 3 of the fair value hierarchy, the amount of the total gains or losses for the period in (e)(i) included in surplus or deficit that is attributable to the change in unrealized gains or losses relating to those assets and liabilities held at the end of the reporting period, and the line item(s) in surplus or deficit in which those unrealized gains or losses are recognized.~~
- ~~(g) For recurring and non-recurring fair value measurements categorized within Level 3 of the fair value hierarchy, a description of the valuation processes used by the entity (including, for example, how an entity decides its valuation policies and procedures and analyses changes in fair value measurements from period to period).~~
- ~~(h) For recurring fair value measurements categorized within Level 3 of the fair value hierarchy:~~

- (i) ~~For all such measurements, a narrative description of the sensitivity of the fair value measurement to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement. If there are interrelationships between those inputs and other unobservable inputs used in the fair value measurement, an entity shall also provide a description of those interrelationships and of how they might magnify or mitigate the effect of changes in the unobservable inputs on the fair value measurement. To comply with that disclosure requirement, the narrative description of the sensitivity to changes in unobservable inputs shall include, at a minimum, the unobservable inputs disclosed when complying with (d).~~
- (ii) ~~For financial assets and financial liabilities, if changing one or more of the unobservable inputs to reflect reasonably possible alternative assumptions would change fair value significantly, an entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to reflect a reasonably possible alternative assumption was calculated. For that purpose, significance shall be judged with respect to surplus or deficit, and total assets or total liabilities, or, when changes in fair value are recognized in net assets/equity, total equity.~~
- (i) ~~For recurring and non-recurring fair value measurements, if the highest and best use of a non-financial asset differs from its current use, an entity shall disclose that fact and why the non-financial asset is being used in a manner that differs from its highest and best use.~~
76. ~~An entity shall determine appropriate classes of assets and liabilities on the basis of the following:~~
- (a) ~~The nature, characteristics and risks of the asset or liability; and~~
- (b) ~~The level of the fair value hierarchy within which the fair value measurement is categorized.~~
- ~~The number of classes may need to be greater for fair value measurements categorized within Level 3 of the fair value hierarchy because those measurements have a greater degree of uncertainty and subjectivity. Determining appropriate classes of assets and liabilities for which disclosures about fair value measurements should be provided requires judgement. A class of assets and liabilities will often require greater disaggregation than the line items presented in the statement of financial position. However, an entity shall provide information sufficient to permit reconciliation to the line items presented in the statement of financial position. If another IPSAS specifies the class for an asset or a liability, an entity may use that class in providing the disclosures required in this Application Guidance if that class meets the requirements in this paragraph.~~
77. ~~An entity shall disclose and consistently follow its policy for determining when transfers between levels of the fair value hierarchy are deemed to have occurred in accordance with paragraph (c) and (e)(iv). The policy about the timing of recognizing transfers shall be the same for transfers into the levels as for transfers out of the levels. Examples of policies for determining the timing of transfers include the following:~~
- (a) ~~The date of the event or change in circumstances that caused the transfer.~~
- (b) ~~The beginning of the reporting period.~~
- (c) ~~The end of the reporting period.~~
78. ~~If an entity makes an accounting policy decision to use the exception in paragraph xx of IPSAS 41, it shall disclose that fact.~~

- ~~79. For each class of assets and liabilities not measured at fair value in the statement of financial position but for which the fair value is disclosed, an entity shall disclose the information required by paragraph (b), (d) and (i). However, an entity is not required to provide the quantitative disclosures about significant unobservable inputs used in fair value measurements categorized within Level 3 of the fair value hierarchy required by paragraph (d). For such assets and liabilities, an entity does not need to provide the other disclosures required by this Application Guidance.~~
- ~~80. For a liability measured at fair value and issued with an inseparable third party credit enhancement, an issuer shall disclose the existence of that credit enhancement and whether it is reflected in the fair value measurement of the liability.~~
- ~~81. An entity shall present the quantitative disclosures required by this Application Guidance in a tabular format unless another format is more appropriate.~~

## Appendix C: Historical cost—application guidance for assets<sup>2</sup>

This Appendix is an integral part of [\[draft\] IPSAS \[X\] \(ED XX\) IPSAS XX, Measurement](#).

### Measurement

#### Historical Cost and Consideration

[Paragraph C1C4](#) is based on the IPSASB's Conceptual Framework 7.13

[C1. 4](#)—Historical cost ~~for an asset~~ is the consideration given to acquire or develop an asset, which is the cash or cash equivalents or the value of the other consideration given, at the time of its acquisition or development. The objective of an historical cost measurement of an asset is to identify the consideration given to acquire and/or develop the asset.

[C1-C2.](#) An historical cost measurement requires an entity to determine all the following:

- (a) The particular asset that is the subject of the measurement (consistently with its unit of account).
- (b) The consideration the entity gave to acquire and/or develop the asset. in terms of:
  - (i) Cash;
  - (ii) Cash equivalents; and
  - (iii) The value of other consideration.
- (c) Factors used to identify what consideration should be included in (or excluded from) the asset's historical cost, including (for example) costs that are directly attributable to its acquisition and/or development and should be included (or not directly attributable and should be excluded).

~~Deferred payment~~[Payment—cash—Cash price—Price equivalent](#)[Equivalent](#)

[Paragraph C3C3](#) is based on IPSAS 16.31

[C2-C3.](#) If payment for an asset is deferred, then the consideration to include in its historical cost is the cash price equivalent of the payment. The difference between this amount and the total payments is recognized as interest expense over the period of credit.

~~The value~~[Value of other](#)~~Other consideration~~[Consideration](#): Exchange for ~~non~~[Non-monetary](#)~~Monetary~~[Asset](#)(s)

[Paragraph C4C4](#) is based on IPSAS 17.38

[C3-C4.](#) The consideration for an asset acquired in exchange for a nonmonetary asset or assets, or a combination of monetary and non-monetary assets, is the appropriate current value of the asset(s)

<sup>2</sup> *For Basis for Conclusions: 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 IPSASs, rather than IPSAS, Measurement.*

given up<sup>3</sup>, unless (a) the transaction is non-exchange or otherwise lacks commercial substance or (b) the current value of the asset given up cannot be measured to achieve the qualitative characteristics, taking into account the constraints. In those circumstances, the consideration for the acquired asset is the carrying amount of the asset given up.

*Historical cost not possible in some circumstances*

~~C4. In the case of donated assets or first time adoption where there are no records of consideration given, historical cost is not available, and therefore, by definition, cannot be used. In these cases an appropriate current value measurement basis could be used instead of historical cost to measure the asset<sup>4</sup>.~~

**The ~~asset~~ Asset measured ~~Measured~~ at ~~historical~~ Historical cost ~~Cost~~**

C5. The asset measured at historical cost might be one of the following:

- (a) A stand-alone asset; or
- (b) A group of assets;
- (c) Assets that form part of a group of assets and liabilities (e.g., a cash-generating unit or an operation).

C6. Whether the asset is a stand-alone asset, a group of assets, or assets that form part of a group of assets and liabilities for recognition or disclosure purposes depends on its *unit of account*. The unit of account for the asset shall be determined in accordance with the IPSAS that requires or permits the historical cost measurement.

**Historical ~~cost~~ Cost is ~~entity~~ Entity specific ~~Specific~~ and ~~asset~~ Asset specific**

C7. Historical cost is an entity-specific measurement basis. Identification of the consideration given to acquire and/or develop the asset requires an understanding of the entity-specific:

- (a) Processes to acquire and/or develop the asset; and
- (b) Procedures and timing for asset use (i.e. its use to provide services and/or generate cash flows).

C8. The entity's (a) acquisition and development processes and (b) asset usage timing and procedures are also asset-specific, so that an historical cost measurement depends on collecting information about how the entity acquired and/or developed the particular asset that and is either readying for use or has put into use.

**The ~~asset's~~ Asset's acquisition ~~Acquisition~~ and/or ~~development~~ Development**

**C9. When measuring historical cost an entity shall identify the consideration applicable to the asset's acquisition and/or development, by taking into account:**

- (a) The entity's process to acquire and/or develop the asset;**

<sup>3</sup> Refer to the consultation paper's flow chart as guidance for choice of an appropriate current value. IPSAS 16 and 17 presently require that the cost of such an asset is measured at fair value, using the "old" definition of fair value, which is equivalent to the Conceptual Framework's definition of market value, and allows for either an entry value or an exit value.

<sup>4</sup> ~~Include more on the choice of an appropriate current value measurement basis, once the IPSASB has reviewed and approved the consultation paper's flow chart for asset measurement.~~

- (b) The period during which the entity incurred acquisition costs and/or development costs for the asset; and
- (c) When the entity began to use the asset to provide services and/or generate future economic benefits.

Process to ~~acquire~~Acquire, ~~construct~~Construct, and/or ~~develop~~Develop an ~~asset~~Asset

C10. The process to acquire an asset may be relatively simple (e.g. purchase of a car or a bond) or complex (e.g. development of new software or construction of a subway line).

C11. The purchase of an asset may be followed by further expenditures to adapt the asset for the entity's own use and, until the asset is able to be used by the entity for its intended purpose, expenditures necessary to bring the asset into use will be included in the consideration identified as part of the asset's historical cost.

Acquisition of an ~~asset~~Asset through ~~purchase~~Purchase: The ~~consideration~~Consideration givenGiven

Paragraph ~~D-3~~C12 is based on IPSAS 16.28

**C12. The consideration of a purchased asset is the price paid to acquire the asset and any directly attributable expenditure. Directly attributable expenditure includes:**

- (a) Transaction costs arising when acquiring an asset;
- (b) Transport costs incurred to transport the asset from the location where it was purchased to the place where it is used by the entity; and
- (c) Expenditures necessary to adapt the asset for the entity's own use.

Paragraph C13~~C13~~ is based on the IASB's Conceptual Framework BC6.32 and BC6.33

~~(e)~~C13. Transaction costs incurred in acquiring an asset are a feature of the transaction in which the asset was acquired. The historical cost of the asset reflects those transaction costs as the entity could not have acquire the asset without incurring those costs. Transaction costs that could be incurred in selling or disposing of the asset are feature of a possible future transaction. Historical cost do not include these possible transaction costs because, as an entry value, historical cost reflects the costs of acquiring the asset.

Construction and ~~development~~Development of an ~~asset~~Asset: The ~~consideration~~Consideration givenGiven

**~~C13~~C14. The consideration of an asset that the entity has constructed or developed itself comprises:**

- (a) The consideration of purchased assets used in the construction or development of the asset; and
- (b) Other consideration directly attributable to the asset's construction or development.

Purchase, ~~construction~~Construction and ~~development~~Development of an ~~asset~~Asset: Examples of ~~consideration~~Consideration to ~~include~~Include

Paragraph C15~~C15~~ is based on IPSAS 17.30 and IPSAS 17.31

**C14-C15. Consideration includes costs that are directly attributable to the asset's acquisition and/or development, and these should be included in the asset's historical cost. Examples include:**

- (a) The asset's purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- (b) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Examples of such costs include:
  - (i) Costs of employee benefits (as defined in IPSAS 25, *Employee Benefits*) arising directly from the construction or acquisition of the asset;
  - (ii) Costs of site preparation;
  - (iii) Initial delivery and handling costs;
  - (iv) Installation and assembly costs;
  - (v) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and
  - (vi) Professional fees arising directly from bringing the asset to its working condition.
- (c) Estimated costs to discharge an entity's obligations to dispose of the asset or restore the location/situation prior to acquiring and/or developing the asset, where those obligations are incurred either when the item is acquired, or as a consequence of having used the item during the asset acquisition and/or development period.

*Purchase, ~~construction~~Construction and ~~development~~Development of an ~~asset~~Asset: Examples of ~~consideration~~Consideration to ~~exclude~~Exclude*

**C15-C16. Costs related to an asset's acquisition and/or development are excluded from the consideration that forms part of an asset's historical cost, if they either:**

- (a) Are not directly attributable to the asset's acquisition and/or development; or
- (b) Do not contribute to the asset's service potential and/or ability to generate future economic benefits.

<b><u>(b)</u> Paragraph C17C17 is based on IPSAS 12.25 and IPSAS 17.36</b>
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**C16-C17. Examples of such costs include:**

- (a) Administration and other general overhead costs.
- (b) Start-up costs that are not necessary to bring the asset to the condition necessary for it to be capable of operating in the manner intended by management. For example,
  - (i) Costs of opening a new facility or introducing a new product or service (including costs of advertising and promotional activities); and
  - (ii) Costs of conducting business in a new location or with a new class of customers (including costs of staff training).

- (c) Costs of operations that are unnecessary and incidental to the asset, even though the costs may occur before or during the asset's acquisition, construction or development activities. For example, a building site may be operated as a car park until construction starts. The car park operations are not necessary to construction of the building (i.e. bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management), and the related revenue and expenses are recognized in surplus or deficit, rather than included in the building's historical cost.
- (d) Operating losses incurred before the asset achieves its intended level of use; or
- (e) Abnormal amounts of wasted material, labor or other resources incurred in constructing or developing the asset.

Excluded: Costs ~~incurred~~~~Incurred prior~~~~Prior~~ to ~~recognition~~~~Recognition~~ of an ~~asset~~~~Asset~~

~~C17-C18.~~ Costs are excluded from an asset's historical cost where those costs occur before the point at which another IPSAS allows that an asset should be recognized. For example, IPSAS 31, *Intangible Assets*, specifies that expenditure incurred before the date when an internally generated intangible asset first meets the recognition criteria in IPSAS 31, *Intangible Assets*, shall be expensed. IPSAS 31 prohibits reinstatement of expenditure previously recognized as an expense.

Excluded: Costs ~~incurred~~~~Incurred after~~~~After~~ the ~~acquisition~~~~Acquisition~~ and/or ~~development~~~~Development~~ of the ~~asset~~~~Asset~~

~~Paragraph C19C19~~ is based on IPSAS 31.37

~~C18-C19.~~ Once the entity has acquired and/or completed the adaption or development of an asset, further costs are not included in the asset's historical cost. For example, once an asset is in the location and condition necessary for it to be capable of being used in the manner intended by management further costs are excluded from the asset's historical cost. Examples of costs to exclude include:

- (a) Costs incurred while an asset is capable of operating in the manner intended by management and has not yet been brought into use or is operated at less than full capacity;
- (b) Initial operating losses, such as those incurred while demand for the asset's output builds up; and
- (c) Costs of relocating or reorganizing part or all of the entity's operations.

### Amortized Cost

~~Paragraph C20C20~~ is based on the IASB's Conceptual Framework 6.9

~~C20.~~ The historical cost measurement basis is applied to financial instruments by measuring the instruments at amortized cost. Amortized cost reflects estimates of future cash flows, discounted at a rate determined at initial recognition. The amortized cost of a financial asset or financial liability is updated over time to depict subsequent changes, such as the accrual of interest, the impairment of a financial asset or payments.

~~C21.~~ For variable rate instruments, where the asset or liability bears interest at a variable rate, the discount rate is updated to reflect changes in the variable rate.



## Appendix D: Replacement cost–application guidance

*This Appendix is an integral part of [\[draft\] IPSAS \[X\] \(ED XX\)](#), [IPSAS XX, Measurement](#).*

### Measurement

D1. The objective of replacement cost measurement is to estimate 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. Replacement cost measurement requires an entity to determine all of the following:

- (a) The particular asset that needs to be measured.
- (b) The most economic manner to replace the service potential of the asset.
- (c) The appropriate valuation technique(s), considering the availability of data with which to develop inputs that represent the economic position of the entity.

### The Asset

D2. A replacement cost measurement is for a particular asset. Therefore, when measuring the replacement cost, an entity takes into account the characteristics of the particular asset relevant in determining the replacement cost at the measurement date.

#### *Characteristics of the Asset*

D3. It is often difficult to separate the factors impacting the replacement cost of an asset into characteristics of the asset itself and the asset's intended use, which relate more to the asset's service potential (see paragraph 44 D11). The following characteristics of an asset will often impact the determination of its replacement cost regardless of the asset's intended use:

- (a) The location of the asset; and
- (b) The condition of the asset

#### The Location of the Asset

D4. There may be circumstances where it is appropriate to value a property based on an alternative 'highest and best' use, regardless of its current or originally intended use. For example, this is often the case for the land under buildings which are no longer required in the locality.

D5. However, a jurisdiction will usually deliver services to its citizens from an appropriate location. For example, schools and hospitals will ideally be located within the communities they serve; and local authority offices will be easily accessible to all citizens. The land on which these schools, hospitals or offices are built might be in expensive inner-city sites or in town and city centers rather than on cheaper land further away from the communities they serve. In these circumstances, the entity should consider these social policy reasons for particular locations, which will often not reflect its 'highest and best' use, and value the replacement cost of the land accordingly.

#### The Condition of the Asset

D6. The replacement cost presented in the Statement of Financial Position and Notes to the Financial Statements should reflect the cost of replacing the service capacity of the asset at the reporting date. Thus the current gross replacement cost of a modern equivalent asset is adjusted by making deductions for physical obsolescence, functional obsolescence, and economic obsolescence (see

paragraphs D30~~30~~ to D32~~32~~), which are also used to assist in determining the useful economic life of the asset.

### Componentization

- D7.** An entity is required to allocate the amount initially recognized in respect of an item of property, plant, and equipment to its significant parts and depreciate separately each such part. For example, an office building might comprise its external structure (foundations, walls, floors and roof—all of which have different design lives); its internal fit-out (offices, reception area, kitchen and canteen—which might have different lives; and plant (elevators, for example). The replacement cost of the building as a whole will normally have a separate useful life and replacement cost when compared to each component. The assessment of the remaining life of the external structure and the plant may be based on a consideration of the physical obsolescence as noted in paragraph ~~30~~D30.
- D8.** It is therefore important that the entity identifies the ‘significant parts’ or components before the assessment of the replacement cost of the service capacity of the asset can begin. This is because the extent of componentization adopted by the entity could affect the scope of work in terms of the information collected during the assessment. In identifying components, an entity should have regard to the materiality of the asset(s) in relation to the Statement of Financial Position and also think carefully about what is ‘significant’ so as not to make the accounting process overly burdensome but at the same to ensure that the information presented in the financial statements is of relevance to users.

Paragraph D9 is based on IPSAS 17.61

- D9.** There may be circumstances where an asset does not have any individually significant components, or the components of the asset all have similar useful lives and depreciation methods. Such components may be grouped in determining the replacement cost (and subsequent depreciation charge) of the asset as a whole.
- D10.** Similarly, groups of assets which all have a similar useful life and depreciation method may be grouped in determining the replacement cost and subsequent depreciation charge for the entire group of assets. Such circumstances may exist where multiple assets are interdependent and have similar useful lives. For example, different types of infrastructure, including dams, waterways, clean water supply, and grey and dirt water treatment facilities; roads and road-related structures; rail networks; as well as electricity and gas supply networks may have assets that are all depreciated over similar time periods and on the same basis. However, in other cases, even though these assets work together to perform a single related function, each asset within the group may consist of significant components with different useful lives and replacement costs, so an entity will need to apply judgement to determine the appropriate level of componentization.

### The Service Potential of the Asset

NOTE: Paragraphs D11 and D12 are based on 7.41 of the conceptual framework.

- D11.** The appropriate service potential is that which the entity is capable of using or expects to use, having regard to the need to hold sufficient service capacity to deal with contingencies. Therefore, the replacement cost of an asset reflects expected changes in required service capacity.
- D12.** For example, if an entity owns a school that accommodates 500 pupils but, because of demographic changes since its construction, a school for 100 pupils would be adequate for the current and

reasonably foreseeable requirements, the replacement cost of the asset is that of a school for 100 pupils.

**D13. When estimating the service potential of an asset, an entity shall take into account the characteristics of the asset, which include:**

**(a) The intended use of the asset;**

**(b) The specifications of the asset; and**

**(c) Restrictions, if any, on the sale or use of the asset.**

*The Intended Use of the Asset*

**D14. In carrying out an assessment of the replacement cost of land and built property, it is the use to which the asset has been put that will be the basis of the calculation of the replacement cost. For example, the replacement cost of an aircraft hangar that is being used as a storage warehouse will be that of a warehouse. Another example might be where city center land has been designated by the local authority as parkland.**

*The Specifications of the Asset*

**D15. There are several examples in the public sector of assets whose specifications are such that there are few (if any) similar assets whose replacement cost can be assessed in an active and liquid market.**

Buildings of Conventional Appearance that have Specialized Features

**D16. Some buildings have a conventional basic design that is superficially similar to other buildings that are regularly bought and sold in the market, but on closer inspection have specialized features designed to meet the requirements of the actual occupier. A typical example is a purpose-built embassy, which, although built to perform an office function, is situated on a site that includes extra stand-off land and includes designed-in security features such as thickened walls and toughened glazing. This type of building will often cost considerably more to develop and build than a normal office building, but provide extra service potential (in the form of security for its occupants) which cannot be replicated through the purchase of a normal office building. In this instance, provided that the occupying entity continues to require the extra service potential, the building should be treated as specialized and its replacement cost should take into account the extra cost of the specialized internal features and requirement for stand-off land.**

Buildings that Include Specialized Adaptations

**D17. As another example, some buildings will comprise conventional structures that have been adapted to the requirement of the occupier. For example, a commercial office building may have been purchased by a government department and adapted by provision of enhanced security features such as perimeter barriers or toughened glazing. An entity might opt to treat the cost of such specialized adaptations as a separate item in its financial statements<sup>5</sup>; in these cases, the entity will value the conventional building. Where the entity has not accounted for the costs of adaptation separately, the entity will need to consider whether the adaptations would impact the building's replacement cost.**

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<sup>5</sup> As a guide, whilst specialized features designed-in to purpose-built buildings should normally be accounted for as part of the whole building, adaptations to existing buildings should normally be accounted for separately.

D18. Where an entity opts to include the adaptation costs within the property interest, the entity will need to ensure that those performing the valuation understand the general nature of the adaptations. It will not be appropriate, for example, for an entity to value an embassy's additional stand-off land (see paragraph D17~~47~~) as surplus land: it is a necessary part of the property. Nor will it be appropriate for an entity to value a newly built embassy building as a conventional office block.

#### Historic Buildings

D19. It is rarely appropriate to value historic buildings on the basis of costing a modern reproduction by use of an identical replacement or modified reconstruction approach. Where an entity is considering doing so, it must be able to demonstrate that it is not valuing a mere facsimile of the existing asset and that the historic property itself is intrinsically part of the service potential.

D20. Where the historic nature of the property itself contributes to the service provided, it would be appropriate to reflect the cost of reproducing the existing asset in the cost of the modern equivalent. For example, in the event of loss, a parliament building may be reproduced rather than replaced with alternative accommodation, because of its significance to the community. However, where it would be impossible for a modern reproduction to recreate the original's historic significance, entities should not cost such a reproduction.

D21. Buildings of iconic status (which might or might not be historic or listed) that would be replaced by similarly iconic buildings should be valued on the basis of a modern equivalent asset but including the costs of achieving that iconic status. For example, the replacement cost of an historic court house might be that of a modern court house with the addition of either a façade in keeping with the surrounding buildings, or even a reproduction façade (a replica of the façade of the existing court house.)

#### Restrictions on the Sale or Use of the Asset

D22. The entity should also consider any factors that might affect the cost of replacing the service capacity of the existing asset. The existing use of the asset will be considered in the light of environmental issues such as the present and future characteristics of the location in terms of, for example, forecast demographic changes; local planning policies; national planning policies; existing restrictions on the use of the land and/or buildings; any restrictions on the sale or use of the land and/or buildings. An example of the latter might be where property was donated to a local authority 100 years ago, with restrictive clauses in the Deed of Gift so that the local authority can only use the property for the provision of named services (such as recreational or health).

#### **The Most Economic Cost**

NOTE: Paragraphs D24 and D26 are based on 7.39 and 7.40 of the conceptual framework.

D23. **A replacement cost measure assumes the service potential of the asset is replaced in the least costly manner.**

D24. Replacement cost adopts an optimized approach and may differ from reproduction cost, which is the cost of acquiring an identical asset. Although in many cases the most economic replacement of the service potential will be by purchasing an asset that is similar to that which is controlled, replacement cost may be based on an alternative asset if that alternative would provide the same service potential more cheaply.

### Entity-Specific Value

**D25.** Replacement cost is an entity specific value. An entity shall measure the cost of replacing an asset's service potential using the assumptions from the entity's perspective, assuming the entity acts in its own economic best interest.

**D26.** An entity need not undertake an exhaustive search of all acquisition methods to identify the least costly manner of replacing an asset's service potential, but it shall take into account all information that is reasonably available. In the absence of evidence to the contrary, because entities usually acquire their assets by the most economic means available, replacement cost reflects the procurement or construction process that an entity generally follows. Replacement cost reflect the replacement of service potential in the ordinary course of operations, and not the costs that might be incurred if an urgent necessity arose as a result of some unforeseeable event, such as a fire.

### Transaction Costs

**D27.** As an asset's replacement cost represents an entity-specific entry price to replace the service potential of the asset, transaction costs incurred in acquiring, or that would be incurred in replacing, the asset are included in its determination.

### Valuation Techniques

**D28.** An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data is available to measure the cost of replacing an asset's service potential, maximizing the use of relevant observable inputs and minimizing the use of unobservable inputs.

**NOTE:** paragraphs **D29** and **D35** are taken from IPSAS 17.47 and 17.48 (and amended).

### Market Price or Current Replacement Cost of a Modern Equivalent Asset

**D29.** In many cases, the replacement cost of an asset can be established by reference to the buying price of a similar asset with similar remaining service potential in an active and liquid market. The replacement cost of an item of plant or equipment may be established by reference to the market buying price of components used to produce the asset or the indexed price for the same or a similar asset based on a price for a previous period. In the case of specialized buildings, other man-made structures and some equipment, values may be estimated using replacement cost, which may involve determining the asset's reproduction cost or use of the service units approach.

### Depreciated Replacement Cost

**D30.** Replacement cost is sometimes described as depreciated (or optimized depreciated) replacement cost (DRC), this valuation method measures value by calculating the current replacement cost of a modern equivalent asset and then making deductions (the 'depreciation' of DRC) for the following forms of obsolescence and optimization:

#### Physical Obsolescence

**D31.** Physical obsolescence relates to any loss of service capacity due to the physical deterioration of the asset or its components resulting from its age and use. In assessing physical obsolescence, an entity should also consider any probable future routine, regular maintenance, as such maintenance may provide insight into the asset or its components' useful life and their rate of deterioration.

#### Functional Obsolescence

D32. Functional obsolescence relates to any loss of service capacity resulting from inefficiencies in the asset that is being valued compared to its modern equivalent – is the asset suitable for its current function? Functional obsolescence might occur because of advances or changes in the design and/or specification of the asset, or because of technological advances. For example, advances in health care technology might mean that the asset in use is outdated, or technological advances in military materiel could mean that hardened aircraft hangers would be replaced by different types of structures. Such advances will need to be incorporated into the assessment of functional obsolescence.

#### Economic Obsolescence

D33. Economic obsolescence relates to any loss of utility caused by economic or other factors outside the control of the entity. The loss of service capacity might be temporary or permanent. For example, a school might have been built in a residential area and designed to take 500 pupils but demographic changes have resulted in the need for only 300 school places. The determination of replacement cost will need to reflect this reduction in required service capacity.

#### Reproduction Cost

D34. An entity should consider very carefully whether or not to use a reproduction cost (or restoration cost) as a technique to determine replacement cost. Such considerations should include whether there is a statutory or other requirement to replace an asset with what is essentially a replica and whether an exact reproduction is possible; if not, then a technique that assesses the replacement of a modern equivalent asset is likely to be more appropriate for financial reporting purposes. The guidance in later paragraphs assumes that the replacement cost is that of a modern equivalent asset.

#### Service Units Approach

D35. Under the service units approach, the present value of the remaining service potential of the asset is determined by reducing the current cost of the remaining service potential of the asset before impairment to conform with the reduced number of service units expected from the asset in its impaired state. As in the reproduction cost approach, the current cost of replacing the remaining service potential of the asset before impairment is usually determined as the depreciated reproduction or replacement cost of the asset before impairment, whichever is lower.

#### The Use of Experts to Determine Replacement Cost

D36. In determining the replacement cost of an asset, it is probable that an entity will need to obtain the professional input of experts with an in-depth understanding of the type of asset for which the replacement cost is required. These experts are unlikely to be accountants: these may include, but not be limited to, clinicians (in respect of medical equipment); engineers (for infrastructure assets); and surveyors (for land and built property).

D37. It is important that the preparers of financial statements and the valuers have a clear understanding of each other's requirements and for the preparers of financial statements to have a basic understanding of the approach the relevant expert might adopt in providing a valuation. In the case of surveyors, for example, valuations of property will be carried out in accordance with International Valuation Standards (or their national equivalents); preparers of financial statements will need to have sufficient understanding of the principles contained in those standards in order to be able to:

- (c) Advise the valuator on the scope and objectives of any valuations for financial reporting purposes, which will include discussing the characteristics of the asset (see paragraphs ~~D33~~ - ~~6D6~~ and ~~14D14~~ - ~~D2222~~);

- (d) Discuss and understand the valuation report, including any information about componentization and lives of those components (see paragraphs D77 - D1040); and
- (e) Incorporate the valuations into the records underlying the financial statements (such as a fixed asset register and/or general ledger, for example).

### Other Valuation Considerations

D38. The cost of a modern equivalent asset will reflect the cost that would be incurred if the works were commissioned on the date of valuation. However, there are factors that may result in the cost of a notional replacement being different from that of creating the actual asset.

#### Site Preparation

D39. Work that may have been undertaken to prepare the actual site for occupation might not need to be carried out on an assumed equivalent site. An entity might therefore assume that the site being valued is level and serviced and ready for development.

#### Phasing of Work

D40. A large site may have been developed in phases. The cost of a modern equivalent asset would normally be based on a single phase development, and this should be measured at the building cost at the date of valuation. To reflect the assumption that a public entity cannot identify borrowing costs (the cost of capital) that relate to the construction of a specific asset, an entity should assume that the construction has happened 'instantly'. As a consequence, it follows that there will be no phasing of payments, and there will be no reflection of the cost of capital in the valuation.

#### Optimal Working Conditions

D41. Abnormal working conditions at the actual site are ignored if an alternative site is being valued.

#### Additional costs arising from extending an existing property

D42. These costs should be ignored, since the norm is that the valuation will be of a modern equivalent asset.

#### Contract Variations

D43. Additional construction costs because of design or specification changes should be ignored. The modern equivalent asset being valued will have the same service potential as the existing asset.

#### Planning Changes

D44. Entities should consider whether planning consent would need to be obtained were the modern equivalent asset to be constructed on the actual site.

#### Measurement

~~1. 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. Also sometimes described as depreciated (or optimized depreciated) replacement cost (DRC), this valuation method indicates value by calculating the current replacement cost of a modern equivalent asset and then making deductions (the 'depreciation' of DRC) for physical deterioration and all relevant forms of obsolescence and optimization. Replacement cost adopts an optimized approach and takes account of the characteristics of the asset (see paragraph 6); it is not a cost of reproduction or of restoration.~~

~~NOTE: paragraphs 2 and 4 are taken from IPSAS 17.47 and 17.48 (and amended).~~

~~2. In many cases, the replacement cost of an asset can be established by reference to the buying price of a similar asset with similar remaining service potential in an active and liquid market. The replacement cost of an item of plant or equipment may be established by reference to the market buying price of components used to produce the asset or the indexed price for the same or a similar asset based on a price for a previous period. In the case of specialized buildings, other man-made structures and some equipment, values may be estimated using replacement cost, which may involve determining the asset's reproduction cost or use of the service units approach.~~

~~Reproduction Cost~~

~~3. An entity should consider very carefully whether or not to use a reproduction cost (or restoration cost) as a technique to determine replacement cost. Such considerations should include whether there is a statutory or other requirement to replace an asset with what is essentially a replica and whether an exact reproduction is possible; if not, then a technique that assesses the replacement of a modern equivalent asset is likely to be more appropriate for financial reporting purposes. The guidance in later paragraphs assumes that the replacement cost is that of a modern equivalent asset.~~

~~Service Units Approach~~

~~4. IPSAS 21 explains that, under the service units approach, the present value of the remaining service potential of the asset is determined by reducing the current cost of the remaining service potential of the asset before impairment to conform with the reduced number of service units expected from the asset in its impaired state. As in the reproduction cost approach, the current cost of replacing the remaining service potential of the asset before impairment is usually determined as the depreciated reproduction or replacement cost of the asset before impairment, whichever is lower.~~

~~The Use of Experts to Determine Replacement Cost~~

~~5. In determining the replacement cost of an asset, it is probable that an entity will need to obtain the professional input of experts with an in-depth understanding of the type of asset for which the replacement cost is required. These experts are unlikely to be accountants: these may include, but not be limited to, clinicians (in respect of medical equipment); engineers (for infrastructure assets); and surveyors (for land and built property). This Application Guidance provides preparers of financial statements with an overview of how they might work with these experts to obtain a replacement cost of certain types of asset. In the case of surveyors, valuations of property will be carried out in accordance with International Valuation Standards (or their national equivalents); preparers of financial statements will need to have sufficient understanding of the principles contained in those standards in order to be able to:~~

- ~~(a) Advise the valuer on the scope and objectives of any valuations for financial reporting purposes, which will include discussing the characteristics of the asset (see paragraphs 6–20);~~
- ~~(b) Discuss and understand the valuation report, including any information about componentization and lives of those components (see paragraphs 26–28); and~~
- ~~(c) Incorporate the valuations into the records underlying the financial statements (such as a fixed asset register and/or general ledger, for example).~~

~~The asset~~

~~6. — A replacement cost measurement is for a particular asset. Therefore, when measuring replacement cost, an entity shall take into account the characteristics of the asset, which include:~~

- ~~(a) — The location of the asset;~~
- ~~(b) — The intended use of the asset;~~
- ~~(c) — The specifications of the asset;~~
- ~~(d) — The condition of the asset;~~
- ~~(e) — Restrictions, if any, on the sale or use of the asset; and~~
- ~~(f) — Componentization.~~

~~—— The Location of the Asset~~

~~7. — The location of an asset is generally relevant only to land and built property (although there may be instances where it is also relevant to military equipment — see [TBD]).~~

~~8. — A jurisdiction will usually deliver services to its citizens from an appropriate location. For example, schools and hospitals will ideally be located within the communities they serve; local authority offices will be easily accessible to all citizens. In some cases, therefore, the land on which the schools, hospitals or offices are built might be in expensive inner-city sites or in town and city centers rather than on cheaper land further away from the communities they serve. In these circumstances, the entity should instruct the valuer to take account of these social policy reasons for particular locations, which will often not reflect its ‘highest and best’ use, and value accordingly,~~

~~9. — There may be circumstances where it is appropriate to value the site for an alternative use such as where buildings are no longer required in the locality or on the actual site where they were originally constructed.~~

~~—— The Intended Use of the Asset~~

~~10. — The intended use of an asset is generally relevant only to land and built property.~~

~~11. — In carrying out an assessment of the replacement cost of land and built property, it is the use to which the asset has been put that will be the basis of the calculation of the replacement cost. For example, the replacement cost of an aircraft hangar that is being used as a storage warehouse will be that of a warehouse. Another example might be where city center land has been designated by the local authority as parkland.~~

~~—— The Specifications of the Asset~~

~~12. — There are several examples in the public sector of assets whose specifications are such that there are few (if any) similar assets with similar remaining service potential whose replacement cost can be assessed in an active and liquid market.~~

~~—— Buildings of Conventional Appearance that have Specialized Features~~

~~13. — Some buildings have a conventional basic design that is superficially similar to other buildings that are regularly bought and sold in the market, but on closer inspection have specialized features designed to meet the requirements of the actual occupier. A typical example is a purpose-built embassy, which, although built to perform an office function, is situated on a site that includes extra stand-off land and includes designed-in security features such as thickened walls and toughened glazing. This type of building will often cost considerably more to develop and build than a normal office building, but provide extra service potential (in the form of security for its occupants) which~~

~~cannot be replicated through the purchase of a normal office building. In this instance, provided that the occupying entity continues to require the extra service potential, it is likely that the building should be treated as specialized and valued to DRC with full account taken of the extra cost of the specialized internal features and requirement for stand-off land.~~

~~—— Buildings that Include Specialized Adaptations~~

~~14. Some buildings will comprise conventional structures that have been adapted to the requirement of the occupier. For example, a commercial office building may have been purchased by a government department and adapted by provision of enhanced security features such as perimeter barriers or toughened glazing. An entity might opt to treat the cost of such specialized adaptations as a separate item in its financial statements<sup>6</sup>; in these cases, the valuer will value the conventional building). Where the entity has not accounted for the costs of adaptation separately, the valuer will need to consider whether the adaptations are such that the building should be valued to DRC.~~

~~15. Where an entity opts to include the adaptation costs within the property interest, the entity will need to ensure that the valuer understands the general nature of the adaptations. It will not be appropriate, for example, for a valuer to value an embassy's additional stand-off land (see paragraph 13) as surplus land: it is a necessary part of the property. Nor will it be appropriate for a valuer to value a newly built embassy building as a conventional office block.~~

~~—— Historic buildings~~

~~16. It is rarely appropriate to value historic buildings on the basis of costing a modern reproduction by use of an identical replacement or modified reconstruction approach. Where an entity is considering doing so, it must be able to demonstrate that it is not valuing a mere facsimile of the existing asset and that the historic property itself is intrinsically part of the service potential.~~

~~17. Where the historic nature of the property itself contributes to the service provided, it would be appropriate to reflect the cost of reproducing the existing asset in the cost of the modern equivalent. For example, in the event of loss, a parliament building may be reproduced rather than replaced with alternative accommodation, because of its significance to the community. However, where it would be impossible for a modern reproduction to recreate the original's historic significance, entities should not cost such a reproduction.~~

~~18. Buildings of iconic status (which might or might not be historic or listed) that would be replaced by similarly iconic buildings should be valued on the basis of a modern equivalent asset but including the costs of achieving that iconic status. For example, the replacement cost of an historic court house might be that of a modern court house with the addition of either a façade in keeping with the surrounding buildings, or even a reproduction façade (a replica of the façade of the existing court house).~~

~~—— Infrastructure~~

~~19. [Specifications for different types of infrastructure — dams/waterways/clean water supply/grey and dirty water treatment; roads/road related structures; rail networks; electricity and gas supply networks.]~~

~~—— Plant and equipment~~

---

~~<sup>6</sup>As a guide, whilst specialized features designed in to purpose built buildings should normally be accounted for as part of the whole building, adaptations to existing buildings should normally be accounted for separately.~~

~~20. [Military equipment, clinical equipment?]~~

~~—— The Condition of the Asset~~

~~21. The replacement cost presented in the Statement of Financial Position and Notes to the Financial Statements should reflect the cost of replacing the service capacity of the asset at the reporting date. Thus the current gross replacement cost of a modern equivalent asset is adjusted by making deductions for the following, which are also used to assist in determining the useful economic life of the asset:~~

~~—— Physical obsolescence~~

~~22. Physical obsolescence relates to any loss of service capacity due to the physical deterioration of the asset or its components resulting from its age and use. In assessing physical obsolescence, the valuer will also take account of probable costs of future routine, regular maintenance.~~

~~—— Functional obsolescence~~

~~23. Functional obsolescence relates to any loss of service capacity resulting from inefficiencies in the asset that is being valued compared to its modern equivalent — is the asset suitable for its current function? Functional obsolescence might occur because of advances or changes in the design and/or specification of the asset, or because of technological advances. For example, advances in health care technology might mean that the asset in use is outdated, or technological advances in military materiel could mean that hardened aircraft hangers would be replaced by different types of structures: the valuer will discuss the effect of such advances with the entity in order to assess functional obsolescence.~~

~~—— Economic obsolescence~~

~~24. Economic obsolescence relates to any loss of utility caused by economic or other factors outside the control of the entity. The loss of service capacity might be temporary or permanent. For example, a school might have been built in a residential area and designed to take 500 pupils but demographic changes have resulted in the need for only 300 school places. The valuation will reflect this reduction in required service capacity.~~

~~—— Restrictions on the Sale or Use of the Asset~~

~~25. The valuer also considers, in discussion with the entity, any factors that might affect the cost of replacing the service capacity of the existing asset. The existing use of the asset will be considered in the light of environmental issues such as the present and future characteristics of the location in terms of, for example, forecast demographic changes; local planning policies; national planning policies; existing restrictions on the use of the land and/or buildings; any restrictions on the sale or use of the land and/or buildings. An example of the latter might be where property was donated to a local authority 100 years ago, with restrictive clauses in the Deed of Gift so that the local authority can only use the property for the provision of named services (such as recreational or health).~~

~~—— Componentization~~

~~26. IPSAS 17 paragraph 60 states that ‘an entity allocates the amount initially recognized in respect of an item of property, plant, and equipment to its significant parts and depreciates separately each such part.’ Paragraph 61 states that significant parts with similar remaining useful lives can then be grouped together; the remaining parts will also be grouped together and ‘approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.~~

~~27. It is therefore important that the entity identifies the 'significant parts' or components and discusses these with the valuer before the assessment of the replacement cost of the service capacity of the asset can begin. This is because the extent of componentization adopted by the entity could affect the scope of the valuer's work in terms of the information collected during the assessment. In identifying components, an entity should have regard to materiality of the asset(s) in relation to the Statement of Financial Position and also think carefully about what is 'significant' so as not to make the accounting process over burdensome but at the same time to ensure that the information presented in the financial statements is of relevance to users.~~

~~28. For example, an office building might comprise its external structure—foundations, walls, floors and roof—all of which have different design lives; its internal fit-out (offices, reception area, kitchen and canteen) which might have different lives; and plant (elevators, for example). If the building has been measured at (depreciated) replacement cost, the valuer's report will normally have assigned a life and a cost to each component based on discussions with the entity as to, for example, the policy on refitting the internal structure. The assessment of the remaining life of the external structure and the plant will be based on a consideration of the physical obsolescence as noted in paragraph 22. An entity may elect to depreciate the component parts separately. If the entity elects to depreciate the building as one asset, however, the valuer will provide a single useful life for the asset using judgement to arrive at an overall life which may or may not be an average of the lives of the components. In such cases, the entity will need to~~

~~—— Other Considerations~~

~~29. The cost of a modern equivalent asset will reflect the cost that would be incurred if the works were commissioned on the date of valuation. However, there are factors that may result in the cost of a notional replacement being different from that of creating the actual asset.~~

~~—— Site preparation~~

~~30. Works that may have been undertaken to prepare the actual site for occupation might not need to be carried out on an assumed equivalent site. An entity might therefore instruct the valuer to assume that the site being valued is level and serviced and ready for development.~~

~~—— Phasing of work~~

~~31. A large site may have been developed in phases. The cost of a modern equivalent asset would normally be based on a single phase development, and this should be measured at the building cost at the date of valuation. To reflect the assumption that a public entity cannot identify borrowing costs (the cost of capital) that relate to the construction of a specific asset, an entity should instruct the valuer to assume that the construction has happened 'instantly'. As a consequence, it follows that there will be no phasing of payments, and there will be no reflection of the cost of capital in the valuation.~~

~~—— Optimal working conditions~~

~~32. Abnormal working conditions at the actual site are ignored if an alternative site is being valued.~~

~~—— Additional costs arising from extending an existing property~~

~~33. These costs should be ignored, since the norm is that the valuation will be of a modern equivalent asset.~~

~~—— Contract variations~~

~~34. Additional construction costs because of design or specification changes should be ignored. The modern equivalent asset being valued will have the same service potential as the existing asset.~~

~~—— Planning changes~~

~~35. Entities should consider with the valuer whether planning consent would need to be obtained were the modern equivalent asset to be constructed on the actual site~~

~~—— Disclosures in Respect of Measurement~~

~~—— Note: the disclosures in paragraph 36 are taken from IPSAS 16.86(e) and (g), IPSAS 16.88, and IPSAS 17.92 (all amended)~~

~~36. An entity shall disclose:~~

~~(a) The extent to which the replacement cost of any asset (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognized and relevant professional qualification and has recent experience in the location and category of the asset being valued. If there has been no such valuation, that fact shall be disclosed;~~

~~(b) The existence and amounts of restrictions on the realizability of any asset or the remittance of revenue and proceeds of disposal;~~

~~(c) When a valuation obtained for any asset is adjusted significantly for the purpose of the financial statements, the entity shall disclose a reconciliation between the valuation obtained and the adjusted valuation included in the financial statements.~~

~~(d) The effective date of the revaluation;~~

~~(e) Whether an independent valuer was involved;~~

~~(f) The methods and significant assumptions applied in estimating the assets' replacement costs;~~

~~(g) The extent to which the assets' replacement costs were determined directly by reference to observable prices in an active market or recent market transactions on arm's length terms, or were estimated using other valuation techniques;~~

~~(h) The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders or other equity holders;~~

~~(i) The sum of all revaluation surpluses for individual items of property, plant, and equipment within that class; and~~

~~(j) The sum of all revaluation deficits for individual items of property, plant, and equipment within that class.~~

~~——~~

~~——~~

~~— [Appendix E: Measurement of assets held for sale or disposal]~~

~~— This Appendix is an integral part of IPSAS XX, Measurement.~~

~~— [Include content (as necessary) for March 2019 IPSASB meeting.]~~

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## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, [draft] IPSAS [X] (ED XX)*

### Introduction

*The ~~purpose~~ Purpose of ~~measurement~~ Measurement in ~~Public sector~~ Sector ~~Financial statements~~ Statements*

- BC1. The purpose of measurement in public sector financial statements is to provide information about assets and liabilities that users' need for accountability and decision-making. Measurement that fairly reflects the cost of services, operational capacity and financial capacity of a public sector entity supports users' assessments of such matters as:
- (a) Whether the entity provided its services to constituents in an efficient and effective manner;
  - (b) The resources currently available for future expenditures, and to what extent there are restrictions or conditions attached to their use;
  - (c) To what extent the burden on future-year taxpayers of paying for current services has changed; and
  - (d) Whether the entity's ability to provide services has improved or deteriorated compared with the previous year.

*Service ~~delivery~~ Delivery ~~objective~~ Objective and ~~public~~ Public ~~sector~~ Sector ~~assets~~ Assets and ~~liabilities~~ Liabilities*

- BC2. Public sector measurement should take into account both the primary objective of most public entities and the type of assets and liabilities that such entities hold. The primary objective of most public sector entities is to deliver services to the public, rather than to make profits and generate a return on equity to investors. The type of assets and liabilities that a public sector entity holds is likely to reflect this objective. For example, in the public sector the primary reason for holding property, plant, and equipment and other assets is for their service potential rather than their ability to generate cash flows. Because of the types of services provided, a significant proportion of assets used by public sector entities is specialized—for example, roads and military assets. There may be a limited market for specialized assets and, even then, they may need considerable adaptation in order to be used by other operators. These factors have implications for the measurement of such assets.
- BC3. Another common feature of public sector assets is that they have restrictions on their use, which need to be taken into account when measurement aims to derive a value that reflects existing use. Measurement issues arise even where there are no restrictions and the aim is to reflect an asset's highest and best use.
- BC4. Governments and other public sector entities may hold items that contribute to the historical and cultural character of a nation or region—for example, art treasures, historical buildings, and other artifacts. They may also be responsible for national parks and other areas of natural significance with native flora and fauna. Such items and areas are not generally held for sale, even if markets exist. Rather, governments and public sector entities have a responsibility to preserve and maintain them for current and future generations.

- BC5. Governments and other public sector entities incur liabilities related to their service delivery objectives. Many liabilities arise from non-exchange transactions and include those related to programs that operate to deliver social benefits. Liabilities may also arise from governments' role as a lender of last resort and from any obligations to transfer resources to those affected by disasters. In addition many governments have obligations that arise from monetary activities such as currency in circulation.

*Measurement of ~~assets-Assets~~ and ~~liabilities-Liabilities~~ for ~~financial-Financial reporting-Reporting~~ by ~~public-Public sector-Sector~~ ~~entities-Entities~~*

- BC6. Chapter 7 of *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) addresses measurement of assets and liabilities in the financial statements. In developing Chapter 7 the IPSASB took into account the special characteristics of the public sector, the needs of users, public sector entities' objectives, different types of assets and liabilities, and the importance of service potential.
- BC7. Where an asset is held primarily for its service potential, rather than its ability to generate future economic benefits, its measurement should provide information on the value of the asset's service potential to the entity. This was an important consideration for the IPSASB, as it developed concepts for public sector measurement and identified appropriate measurement bases for use in the public sector.
- BC8. The objective of measurement and the measurement bases in Chapter 7 of the Conceptual Framework address public sector financial reporting needs. They differ from objectives and measurement bases developed for private sector entities that operate to make a profit and value assets and liabilities in terms of their ability to generate future economic benefits, which focuses on future cash flows. The objective of measurement is:
- To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.
- BC9. The measurement bases identified in Chapter 7 are: historical cost, market value, replacement cost, net selling price, and value in use, for assets; and, historical cost, cost of fulfillment, market value, cost of release, and assumption price, for liabilities.

*Relationship ~~b~~Between ED, Measurement and ~~e~~Other IPSASs*

- BC10. During development of this ED the IPSASB considered including all requirements with respect to measurement of assets and liabilities in one Standard, in order to provide a comprehensive "one stop shop". However, the IPSASB concluded that other IPSAS should address impairment, depreciation, amortization, and any specific measurement requirements relating to the assets or liabilities covered by the IPSAS, for example the measurement of intangible assets or of employee benefit liabilities. IPSAS, *Measurement*, should provide the definitions and generic application guidance for the measurement bases identified in the Conceptual Framework and fair value. The aim is to support consistent application of measurement bases referred to in other IPSAS.
- BC11. The IPSASB decided to develop application guidance for the following four measurement bases: cost of fulfillment, fair value, historical cost, and replacement cost, because the greater need for application guidance relates to these four measurement bases. Appendices with application guidance on other measurement bases may be added in the future.

Application Guidance on Fair Value in IPSAS and IFRS 13, Fair Value Measurement

BC12. This ED has application guidance for the fair value measurement basis. During development of this ED the IPSASB considered whether the fair value measurement basis was relevant to measuring assets and liabilities held by public sector entities. The IPSASB concluded that: there are assets and liabilities held by public sector entities, which should be measured at fair value; and, the term “fair value” should have the same meaning as that established by IFRS 13, *Fair Value Measurement*.

BC13. In reaching these two conclusions the IPSASB noted that there are references to fair value throughout IPSAS, however the IPSAS definition of fair value is a derived from a pre-IFRS 13 definition. IFRS 13 defines fair value as an exit value, as follows:

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

BC14. The IPSASB’s Conceptual Framework does not include fair value in its list of measurement bases, because the IPSASB considered that the IFRS 13 meaning of fair value would not be appropriate for many public sector assets and liabilities, because it is an exit value. However, during development of this ED the IPSASB’s work on financial instruments has demonstrated that an exit-based definition of fair value is relevant for many financial instruments and more generally assets held for financial rather than operational capacity.

BC15. The IPSASB decided, with support from members of its Consultative Advisory Group (CAG), that if the term “fair value” continues to be used in IPSAS, the same meaning as that in IFRS 13 should apply. This avoids confusion and supports good quality measurement, when using this measurement basis.

BC16. In June 2018 the IPSASB approved IPSAS 41, *Financial Instruments*, which is an IFRS-aligned IPSAS. IPSAS 41 identifies fair value as a measurement basis applicable to financial instruments. The IPSASB had already decided, in September 2017, that the Public Sector Measurement project should allow for measurement at fair value, with the issue being one of how to integrate the IFRS 13 definition of fair value into IPSAS. The IPSASB decided that IPSAS, *Measurement*, should include the majority of IFRS 13 text to ensure that its definition of fair value would be consistent with that in IFRS 13, and adequately support IPSAS 41’s requirements with respect to measurement of financial instruments at fair value. On that basis the ED’s appendix with fair value application guidance has reproduced the majority of IFRS 13 text and aims to ensure that the ED’s definition of fair value is the same as that established in IFRS 13.

~~BC10. Fair value is a specified measurement basis in many IPSASs. The Conceptual Framework does not include fair value as a measurement basis, although its definition of “market value” is the same as the current IPSAS definition of “fair value,” which is either an entry value or an exit value.~~

~~BC11. The IPSASB decided not to include fair value in the Conceptual Framework because:~~

~~(a) Fair value is similar to market value and the inclusion of both measurement bases could be confusing to users of financial statements; and~~

~~(a) The IFRS 13, *Fair Value Measurement*, approach to fair value (see below) raises the following issues:~~

~~(i) In the public sector many assets are specialized and differences in entry and exit prices are therefore significant. Where an asset will provide future services or~~

~~economic benefits with a greater value than the asset's exit price, a measure reflecting exit values is not the most relevant basis.~~

- ~~(ii) Fair value in IFRS 13 is, in the IPSASB's view, a model to represent a specific measurement outcome rather than a measurement basis.~~
- ~~(iii) In the Conceptual Framework replacement cost is a measurement basis in its own right, rather than a valuation technique to determine fair value.~~
- ~~(iv) The relevance of fair value in the public sector is likely to be primarily limited to providing information on financial capacity, rather than operating capacity and the cost of services.~~

~~BC12. The International Accounting Standards Board (IASB) issued IFRS 13, *Fair Value Measurement*, in 2011. IFRS 13 defines fair value as an exit value and establishes an approach to fair value measurement involving a hierarchy of inputs and use of measures derived from information about market values, costs and income. When the IPSASB decided against including fair value in the Conceptual Framework it noted, nonetheless, that there could be further work carried out at standards level to explain how the measurement bases in the Conceptual Framework align with IFRS 13's approach to fair value.~~

~~BC13. During development of the draft Standard accompanying this CP, the IPSASB decided:~~

- ~~(a) To apply a rebuttable presumption that IPSAS references to fair value would need revision for better alignment with the Conceptual Framework;~~
- ~~(b) There would be scope to use fair value for some types of assets and liabilities and in some situations; and~~
- ~~(c) Where fair value measurement is applied, the meaning of fair value should be consistent with the meaning in IFRS 13.~~

### **Objective (paragraph 1)**

~~BC14-BC17.~~ ED XX's objective explains that it focuses on the definition of appropriate measurement bases and their derivation. It does not establish requirements for which measurement bases should be used in IPSASs. The ED's objective refers to the objective of measurement in the Conceptual Framework because this underpins its approach to measurement bases and their selection.

### **Scope and definitions (paragraphs 2–3)**

~~BC15-BC18.~~ ED XX's scope conveys that the Standard's definitions of measurement bases and related application guidance applies when another IPSAS requires measurement using one of the defined measurement bases.

### **Subsequent Measurement**

*Depreciation and ~~amortization~~Amortization*

~~BC16-BC19.~~ Depreciation is a charge for the consumption of an asset over its useful life. ED XX does not address depreciation. Requirements and guidance on depreciation are provided at standards-level. For example, IPSAS 17, *Property, Plant and Equipment*, addresses:

- (a) The unit of account for depreciation,

- (b) The recognition of depreciation,
- (c) The point at which depreciation of an asset begins,
- (d) The relationship between economic and useful lives,
- (e) The circumstances under which land may be depreciated,
- (f) Depreciation methods, and
- (g) The relationship between the revenue generated by an asset and depreciation.

~~BC17-BC20.~~ Amortization is the term applied to the consumption of an intangible asset that does not have a physical substance. As for depreciation, requirements and guidance are provided at standards-level, and. ED XX does not address amortization. IPSAS 31, *Intangible Assets*, distinguishes intangible assets with definite and indefinite useful lives, and for the former provides requirements and guidance on amortization periods and methods and their review and residual value.

~~BC18-BC21.~~ The selection of an accounting policy for measurement subsequent to initial recognition may have an impact on whether an asset is depreciated or amortized. This is determined at standards level. For example IPSAS 17 requires that assets on the revaluation model with useful lives are depreciated. IPSAS 16, *Investment Property*, does not require depreciation of an investment property that is measured in accordance with the fair value model subsequent to initial recognition. IPSAS 31 does not permit amortization of an asset that is classified as held for sale.

*Use of the ~~Historical cost model/Model~~ or ~~revaluation/Revaluation model/Model~~*

~~BC19-BC22.~~ The IPSASB accepts that the existence of accounting policy options reduces comparability between reporting entities. The IPSASB discussed whether ED, *Measurement*, should consider the options for measurement subsequent to initial recognition in existing IPSAS with a view to eliminating or reducing those options.

~~BC20-BC23.~~ The IPSASB noted that Chapter Seven of the Conceptual Framework provides a measurement objective:

To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making processes.

~~BC21-BC24.~~ The Conceptual Framework goes on to state that it is not possible to identify a single measurement basis that best meets the measurement objective and acknowledges both historical cost and current value measurements.

~~BC22-BC25.~~ The IPSASB concluded that:

- (a) It would be inconsistent with the Conceptual Framework to eliminate existing accounting policy options for subsequent measurement; and that
- (b) Such a step would be outside the scope of this ED, which is to provide requirements and guidance on the definitions and application of measurement bases (i.e. what is meant by each measurement basis and how to derive measurement bases), rather than to specify where they should be used. The latter is a decision for individual standards.

~~BC23-BC26.~~ A decision on whether to use historical cost or current value for measurement subsequent to initial recognition is likely to be made by regulator(s) in a particular jurisdiction. The

Basis for Conclusions notes that many respondents to the Conceptual Framework Consultation Paper and ED on Measurement advocated the continued widespread use of historical cost, mostly in combination with other measurement bases. Supporters of historical cost referenced the accountability objective of financial reporting, the verifiability of historical cost and its suitability for budget reporting purposes where budgets are prepared on a historical cost basis.

[BC27.](#) –Conversely those who supported current values, and adopted a view that historical cost should be used as a proxy for current value, linked this view to both decision-making and accountability, arguing that the cost of service provision should reflect the value of assets used in service provision at the time they are consumed, rather than their transaction price. Some of these views may inform the decisions of regulators.

#### [Financial Instruments Measured at Historical Cost](#)

~~BC24-BC28.~~ [The amortized cost of a financial asset or financial liability reflects estimates of future cash flows discounted at a rate that is not updated after initial recognition. For loans given or received, if interest is receivable or payable regularly, the amortized cost of the loan typically approximates the amount originally paid or received. Therefore, the amortized cost of a financial asset or liability is considered to be a form of historical cost.](#)

#### **Application guidance**

[Text in the Basis for Conclusions to be determined.]

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**Appendix B – Marked Up IFRS 5, Non-Current Assets Held for Sale and Discontinued Operations**

1. Included in this Appendix is a marked-up version of IFRS 5 to reflect changes required for the standard to be applied in the public sector.
2. As no decision has been made as to whether Assets Held for Sale should be an alignment project, this mark-up is provided for informational purposes only to provide the Board with an overview of the changes required to the document in order to align its IFRS equivalent.

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*from paragraph*

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# International ~~Financial Reporting~~ Public Sector Accounting Standard ~~5XX~~ **Non-current Assets Held for Sale and Discontinued Operations**

## Objective

- 1 The objective of this ~~IFRS-IPSAS~~ is to specify the accounting for assets held for sale, and the presentation and disclosure of *discontinued operations*. In particular, the ~~IFRS-IPSAS~~ requires:
- (a) ~~A~~assets that meet the criteria to be classified as held for sale to be measured at the lower of carrying amount and *fair value less costs to sell* [Measurement basis TBD], and depreciation on such assets to cease; and
  - (b) ~~A~~assets that meet the criteria to be classified as held for sale to be presented separately in the statement of financial position and the results of discontinued operations to be presented separately in the statement of ~~comprehensive income~~ changes in net assets/equity.

## Scope

- 2 The classification and presentation requirements of this IFRS apply to all ~~recogniz~~ed *non-current assets*<sup>1</sup> and to all *disposal groups* of an entity. The measurement requirements of this IFRS apply to all ~~recogniz~~ed non-current assets and disposal groups (as set out in paragraph 4), except for those assets listed in paragraph 5 which shall continue to be measured in accordance with the Standard noted.
- 3 Assets classified as non-current in accordance with IPSAS 1 *Presentation of Financial Statements* shall not be reclassified as *current assets* until they meet the criteria to be classified as held for sale in accordance with this ~~IFRS~~IPSAS. Assets of a class that an entity would normally regard as non-current that are acquired exclusively with a view to resale shall not be classified as current unless they meet the criteria to be classified as held for sale in accordance with this ~~IFRS~~IPSAS.
- 4 Sometimes an entity disposes of a group of assets, possibly with some directly associated liabilities, together in a single transaction. Such a disposal group may be a group of *cash-generating units*, a single cash-generating unit, or part of a cash-generating unit.<sup>2</sup> The group may include any assets and any liabilities of the entity, including current assets, current liabilities and assets excluded by paragraph 5 from the measurement requirements of this ~~IFRS~~IPSAS. If a non-current asset within the scope of the measurement requirements of this ~~IFRS-IPSAS~~ is part of a disposal group, the measurement requirements of this ~~IFRS~~IPSAS apply to the group as a whole, so that the group is measured at the lower of its carrying amount and fair value less costs to sell. The requirements for measuring the individual assets and liabilities within the disposal group are set out in paragraphs 18, 19 and 23.
- 5 The measurement provisions of this ~~IFRS~~IPSAS<sup>3</sup> do not apply to the following assets, which are covered by the IFRSs listed, either as individual assets or as part of a disposal group:
- (a) ~~deferred~~ T~~ax assets~~ \_
  - (b) ~~a~~Assets arising from employee benefits (IPSAS 349 *Employee Benefits*).
  - (c) ~~f~~Financial assets within the scope of IPSA~~FRS 419~~ *Financial Instruments*.
  - (d) ~~n~~Non-current assets that are accounted for in accordance with the fair value model in IPSAS 1640 *Investment Property*.
  - (e) ~~n~~Non-current assets that are measured at fair value less costs to sell in accordance with IPSAS 4427 *Agriculture*.

<sup>1</sup>For assets classified according to a liquidity presentation, non-current assets are assets that include amounts expected to be recovered more than twelve months after the reporting period. Paragraph 3 applies to the classification of such assets.

<sup>2</sup>However, once the cash flows from an asset or group of assets are expected to arise principally from sale rather than continuing use, they become less dependent on cash flows arising from other assets, and a disposal group that was part of a cash-generating unit becomes a separate cash-generating unit.

<sup>3</sup>Other than paragraphs 18 and 19, which require the assets in question to be measured in accordance with other applicable IPSA~~FRS~~s.

- (f) ~~g~~ Groups of contracts within the scope of ~~IFRS 17 Insurance Contracts~~ the relevant international or nation accounting standards dealing with insurance contracts.
- 5A The classification, presentation and measurement requirements in this ~~IPSAFRS~~ applicable to a non-current asset (or disposal group) that is classified as held for sale apply also to a non-current asset (or disposal group) that is classified as held for distribution to owners acting in their capacity as owners (held for distribution to owners).
- 5B This IFRS specifies the disclosures required in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations. Disclosures- in other ~~IPSAFRSs~~ do not apply to such assets (or disposal groups) unless those ~~IPSAFRSs~~ require:
- (a) ~~S~~specific disclosures in respect of non-current assets (or disposal groups) classified as held for sale or discontinued operations; or
- (b) ~~D~~isclosures about measurement of assets and liabilities within a disposal group that are not within the scope of the measurement requirement of ~~IFRS-IPSAS XX5~~ and such disclosures are not already provided in the other notes to the financial statements.

Additional disclosures about non-current assets (or disposal groups) classified as held for sale or discontinued operations may be necessary to comply with the general requirements of ~~IPSAS 1~~, in particular paragraphs ~~2715~~ and ~~140125~~ of that Standard.

## **Classification of non-current assets (or disposal groups) as held for sale or as held for distribution to owners**

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- 6 **An entity shall classify a non-current asset (or disposal group) as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.**
- 7 For this to be the case, the asset (or disposal group) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets (or disposal groups) and its sale must be *highly probable*.
- 8 For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset (or disposal group), and an active program~~me~~ to locate a buyer and complete the plan must have been initiated. Further, the asset (or disposal group) must be actively marketed for sale at a price that is reasonable in relation to its current fair value. In addition, the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification, except as permitted by paragraph 9, and actions required to complete the plan should indicate that it is unlikely that significant changes to the plan will be made or that the plan will be withdrawn. The probability of ~~shareholders' owners'~~ approval (if required in the jurisdiction) should be considered as part of the assessment of whether the sale is highly probable.
- 8A An entity that is committed to a sale plan involving loss of control of a ~~subsidiary-controlled entity~~ shall classify all the assets and liabilities of that ~~subsidiary-controlled entity~~ as held for sale when the criteria set out in paragraphs 6–8 are met, regardless of whether the entity will retain a non-controlling interest in its former ~~subsidiary-controlled entity~~ after the sale.
- 9 Events or circumstances may extend the period to complete the sale beyond one year. An extension of the period required to complete a sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the entity's control and there is sufficient evidence that the entity remains committed to its plan to sell the asset (or disposal group). This will be the case when the criteria in Appendix B are met.
- 10 Sale transactions include exchanges of non-current assets for other non-current assets when the exchange has commercial substance in accordance with ~~IPSAS 167~~ *Property, Plant and Equipment*.
- 11 When an entity acquires a non-current asset (or disposal group) exclusively with a view to its subsequent disposal, it shall classify the non-current asset (or disposal group) as held for sale at the acquisition date only if the one-year requirement in paragraph 8 is met (except as permitted by paragraph 9) and it is highly probable that any other criteria in paragraphs 7 and 8 that are not met at that date will be met within a short period following the acquisition (usually within three months).
- 12 If the criteria in paragraphs 7 and 8 are met after the reporting period, an entity shall not classify a non-current asset (or disposal group) as held for sale in those financial statements when issued. However, when those criteria are met after the reporting period but before the author~~ization~~ of the financial statements for issue, the entity shall disclose the information specified in paragraph 41(a), (b) and (d) in the notes.

- 12A A non-current asset (or disposal group) is classified as held for distribution to owners when the entity is committed to distribute the asset (or disposal group) to the owners. For this to be the case, the assets must be available for immediate distribution in their present condition and the distribution must be highly probable. For the distribution to be highly probable, actions to complete the distribution must have been initiated and should be expected to be completed within one year from the date of classification. Actions required to complete the distribution should indicate that it is unlikely that significant changes to the distribution will be made or that the distribution will be withdrawn. The probability of ~~shareholders'~~ owners' approval (if required in the jurisdiction) should be considered as part of the assessment of whether the distribution is highly probable.

## Non-current assets that are to be abandoned

- 13 An entity shall not classify as held for sale a non-current asset (or disposal group) that is to be abandoned. This is because its carrying amount will be recovered principally through continuing use. However, if the disposal group to be abandoned meets the criteria in paragraph 32(a)–(c), the entity shall present the results and cash flows of the disposal group as discontinued operations in accordance with paragraphs 33 and 34 at the date on which it ceases to be used. Non-current assets (or disposal groups) to be abandoned include non-current assets (or disposal groups) that are to be used to the end of their economic life and non-current assets (or disposal groups) that are to be closed rather than sold.
- 14 An entity shall not account for a non-current asset that has been temporarily taken out of use as if it had been abandoned.

## Measurement of non-current assets (or disposal groups) classified as held for sale

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### Measurement of a non-current asset (or disposal group)

- 15 An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell. [Measurement basis TBD.]
- 15A An entity shall measure a non-current asset (or disposal group) classified as held for distribution to owners at the lower of its carrying amount and fair value less costs to distribute.<sup>4</sup> [Measurement basis TBD.]
- 16 If a newly acquired asset (or disposal group) meets the criteria to be classified as held for sale (see paragraph 11), applying paragraph 15 will result in the asset (or disposal group) being measured on initial recognition at the lower of its carrying amount had it not been so classified (for example, cost) and fair value less costs to sell. Hence, if the asset (or disposal group) is acquired as part of a business-public sector combination, it shall be measured at fair value less costs to sell.
- 17 When the sale is expected to occur beyond one year, the entity shall measure the costs to sell at their present value. Any increase in the present value of the costs to sell that arises from the passage of time shall be presented in profit or loss/surplus or deficit as a financing cost.
- 18 Immediately before the initial classification of the asset (or disposal group) as held for sale, the carrying amounts of the asset (or all the assets and liabilities in the group) shall be measured in accordance with applicable HFRSs/IPSASs.
- 19 On subsequent remeasurement of a disposal group, the carrying amounts of any assets and liabilities that are not within the scope of the measurement requirements of this HFRS/IPSAS, but are included in a disposal group classified as held for sale, shall be remeasured in accordance with applicable HFRSs/IPSASs before the fair value less costs to sell [Measurement basis TBD] of the disposal group is remeasured.

### Recognition of impairment losses and reversals

- 20 An entity shall recognize an impairment loss for any initial or subsequent write-down of the asset (or disposal group) to fair value less costs to sell [Measurement basis TBD], to the extent that it has not been recognized in accordance with paragraph 19.

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<sup>4</sup> Costs to distribute are the incremental costs directly attributable to the distribution, excluding finance costs and income tax expense.

- 21 An entity shall recognize a gain for any subsequent increase in fair value less costs to sell **[Measurement basis TBD]** of an asset, but not in excess of the cumulative impairment loss that has been recognized either in accordance with this ~~IFRS-IPSAS~~ or previously in accordance with ~~IPSAS 21~~<sup>36</sup> *Impairment of Non-Cash-Generating Assets* and ~~IPSAS 26~~ *Impairment of Cash-Generating Assets*.
- 22 An entity shall recognize a gain for any subsequent increase in fair value less costs to sell **[Measurement basis TBD]** of a disposal group:
- ~~To~~ the extent that it has not been recognized in accordance with paragraph 19; but
  - ~~Not~~ in excess of the cumulative impairment loss that has been recognized, either in accordance with this ~~IFRS-IPSAS~~ or previously in accordance with ~~IPSAS 21 and IPSAS 36~~, on the non-current assets that are within the scope of the measurement requirements of this ~~IFRS~~<sup>IPSAS</sup>.
- 23 The impairment loss (or any subsequent gain) recognized for a disposal group shall reduce (or increase) the carrying amount of the non-current assets in the group that are within the scope of the measurement requirements of this ~~IFRS~~<sup>IPSAS</sup>, in the order of allocation set out in paragraphs ~~91~~<sup>104</sup>(a) and (b) and ~~110~~<sup>122</sup> of ~~IPSAS 23~~<sup>6</sup>, ~~(as revised in 2004)~~.
- 24 A gain or loss not previously recognized by the date of the sale of a non-current asset (or disposal group) shall be recognized at the date of derecognition. Requirements relating to derecognition are set out in:
- ~~Paragraphs 82~~<sup>67</sup>–~~87~~<sup>72</sup> of ~~IPSAS 16~~<sup>7</sup> *Property, Plant, and Equipment* ~~(as revised in 2003)~~ for property, plant and equipment, and
  - ~~Paragraphs 11~~<sup>21</sup>–~~11~~<sup>67</sup> of ~~IPSAS 31~~<sup>8</sup> *Intangible Assets* (as revised in 2004) for intangible assets.
- 25 An entity shall not depreciate (or amortize) a non-current asset while it is classified as held for sale or while it is part of a disposal group classified as held for sale. Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale shall continue to be recognized.

## Changes to a plan of sale or to a plan of distribution to owners

- 26 If an entity has classified an asset (or disposal group) as held for sale or as held for distribution to owners, but the criteria in paragraphs 7–9 (for held for sale) or in paragraph 12A (for held for distribution to owners) are no longer met, the entity shall cease to classify the asset (or disposal group) as held for sale or held for distribution to owners (respectively). In such cases an entity shall follow the guidance in paragraphs 27–29 to account for this change except when paragraph 26A applies.
- 26A If an entity reclassifies an asset (or disposal group) directly from being held for sale to being held for distribution to owners, or directly from being held for distribution to owners to being held for sale, then the change in classification is considered a continuation of the original plan of disposal. The entity:
- shall not follow the guidance in paragraphs 27–29 to account for this change. The entity shall apply the classification, presentation and measurement requirements in this ~~IFRS~~<sup>IPSAS</sup> that are applicable to the new method of disposal.
  - shall measure the non-current asset (or disposal group) by following the requirements in paragraph 15 (if reclassified as held for sale) or 15A (if reclassified as held for distribution to owners) and recognize any reduction or increase in the fair value less costs to sell/costs to distribute of the non-current asset (or disposal group) by following the requirements in paragraphs 20–25.
  - shall not change the date of classification in accordance with paragraphs 8 and 12A. This does not preclude an extension of the period required to complete a sale or a distribution to owners if the conditions in paragraph 9 are met.
- 27 The entity shall measure a non-current asset (or disposal group) that ceases to be classified as held for sale or as held for distribution to owners (or ceases to be included in a disposal group classified as held for sale or as held for distribution to owners) at the lower of:
- its carrying amount before the asset (or disposal group) was classified as held for sale or as held for distribution to owners, adjusted for any depreciation, amortization or revaluations that would have been recognized had the asset (or disposal group) not been classified as held for sale or as held for distribution to owners, and
  - its recoverable amount at the date of the subsequent decision not to sell or distribute.<sup>5</sup>

<sup>5</sup> If the non-current asset is part of a cash-generating unit, its recoverable amount is the carrying amount that would have been recognized after the allocation of any impairment loss arising on that cash-generating unit in accordance with ~~IPSAS 23~~<sup>6</sup>.

- 28 The entity shall include any required adjustment to the carrying amount of a non-current asset that ceases to be classified as held for sale or as held for distribution to owners in ~~surplus or deficit~~profit or loss<sup>6</sup> from continuing operations in the period in which the criteria in paragraphs 7–9 or 12A, respectively, are no longer met. Financial statements for the periods since classification as held for sale or as held for distribution to owners shall be amended accordingly if the disposal group or non-current asset that ceases to be classified as held for sale or as held for distribution to owners is a subsidiary, joint operation, joint venture, associate, or a portion of an interest in a joint venture or an associate. The entity shall present that adjustment in the same caption in the statement of comprehensive income used to present a gain or loss, if any, ~~recognis~~ed in accordance with paragraph 37.
- 29 If an entity removes an individual asset or liability from a disposal group classified as held for sale, the remaining assets and liabilities of the disposal group to be sold shall continue to be measured as a group only if the group meets the criteria in paragraphs 7–9. If an entity removes an individual asset or liability from a disposal group classified as held for distribution to owners, the remaining assets and liabilities of the disposal group to be distributed shall continue to be measured as a group only if the group meets the criteria in paragraph 12A. Otherwise, the remaining non-current assets of the group that individually meet the criteria to be classified as held for sale (or as held for distribution to owners) shall be measured individually at the lower of their carrying amounts and fair values less costs to sell (or costs to distribute) at that date. Any non-current assets that do not meet the criteria for held for sale shall cease to be classified as held for sale in accordance with paragraph 26. Any non-current assets that do not meet the criteria for held for distribution to owners shall cease to be classified as held for distribution to owners in accordance with paragraph 26.

## Presentation and disclosure

- 30 **An entity shall present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups).**

### Presenting discontinued operations

- 31 A *component of an entity* comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. In other words, a component of an entity will have been a cash-generating unit or a group of cash-generating units while being held for use.
- 32 A discontinued operation is a component of an entity that either has been disposed of, or is classified as held for sale, and
- ~~R~~epresents a separate major line of ~~business operations~~ or geographical area of operations,
  - ~~I~~s part of a single ~~co-ordinated~~coordinated plan to dispose of a separate major line of ~~business operations~~ or geographical area of operations or
  - ~~I~~s a ~~subsidiary-controlled entity~~ acquired exclusively with a view to resale.
- 33 An entity shall disclose:
- ~~A~~a single amount in the statement of ~~comprehensive income changes in net assets/equity~~ comprising the total of:
    - ~~T~~he ~~[post-tax] profit or loss~~surplus or deficit of discontinued operations and
    - ~~T~~he ~~[post-tax]~~ gain or loss ~~recognis~~ed on the measurement to fair value less costs to sell ~~[Measurement basis TBD]~~ or on the disposal of the assets or disposal group(s) constituting the discontinued operation.
  - ~~A~~n analysis of the single amount in (a) into:
    - ~~T~~he revenue, expenses and ~~[pre-tax] surplus or deficit~~profit or loss of discontinued operations;
    - ~~T~~he ~~related income tax expense as required by paragraph 81(h) of IAS 12.~~

<sup>6</sup>Unless the asset is property, plant and equipment or an intangible asset that had been revalued in accordance with IPSAS 16 or IPSAS 31 before classification as held for sale, in which case the adjustment shall be treated as a revaluation increase or decrease.

(iii) ~~The~~ gain or loss recognized on the measurement to fair value less costs to sell [Measurement basis TBD.] or on the disposal of the assets or disposal group(s) constituting the discontinued operation; and

(iv) ~~[(The related income tax expense as required by paragraph 81(h) of IAS 12.)]~~

The analysis may be presented in the notes or in the statement of ~~comprehensive income~~ changes in net assets/equity. If it is presented in the statement of ~~comprehensive income~~ changes in net assets/equity it shall be presented in a section identified as relating to discontinued operations, i.e., separately from continuing operations. The analysis is not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).

(c) ~~The~~ net cash flows attributable to the operating, investing and financing activities of discontinued operations. These disclosures may be presented either in the notes or in the financial statements. These disclosures are not required for disposal groups that are newly acquired subsidiaries that meet the criteria to be classified as held for sale on acquisition (see paragraph 11).

(d) ~~€~~The amount of income-revenue from continuing operations and from discontinued operations attributable to owners of the parent. These disclosures may be presented either in the notes or in the statement of comprehensive income changes in net assets/equity.

33A ~~If an entity presents the items of profit or loss in a separate statement as described in paragraph 10A of IAS 1 (as amended in 2011), a section identified as relating to discontinued operations is presented in that statement.~~

34 An entity shall re-present the disclosures in paragraph 33 for prior periods presented in the financial statements so that the disclosures relate to all operations that have been discontinued by the end of the reporting period for the latest period presented.

35 Adjustments in the current period to amounts previously presented in discontinued operations that are directly related to the disposal of a discontinued operation in a prior period shall be classified separately in discontinued operations. The nature and amount of such adjustments shall be disclosed. Examples of circumstances in which these adjustments may arise include the following:

(a) ~~The~~ resolution of uncertainties that arise from the terms of the disposal transaction, such as the resolution of purchase price adjustments and indemnification issues with the purchaser.

(b) ~~The~~ resolution of uncertainties that arise from and are directly related to the operations of the component before its disposal, such as environmental and product warranty obligations retained by the seller.

(c) ~~The~~ settlement of employee benefit plan obligations, provided that the settlement is directly related to the disposal transaction.

36 If an entity ceases to classify a component of an entity as held for sale, the results of operations of the component previously presented in discontinued operations in accordance with paragraphs 33–35 shall be reclassified and included in income-revenue from continuing operations for all periods presented. The amounts for prior periods shall be described as having been re-presented.

36A An entity that is committed to a sale plan involving loss of control of a subsidiary-controlled entity shall disclose the information required in paragraphs 33–36 when the subsidiary is a disposal group that meets the definition of a discontinued operation in accordance with paragraph 32.

## Gains or losses relating to continuing operations

37 Any gain or loss on the remeasurement of a non-current asset (or disposal group) classified as held for sale that does not meet the definition of a discontinued operation shall be included in surplus or deficit ~~profit or loss~~ from continuing operations.

## Presentation of a non-current asset or disposal group classified as held for sale

38 An entity shall present a non-current asset classified as held for sale and the assets of a disposal group classified as held for sale separately from other assets in the statement of financial position. The liabilities of a disposal group classified as held for sale shall be presented separately from other liabilities in the statement of financial position. Those assets and liabilities shall not be offset and presented as a single

amount. The major classes of assets and liabilities classified as held for sale shall be separately disclosed either in the statement of financial position or in the notes, except as permitted by paragraph 39. An entity shall present separately any cumulative ~~income-revenue~~ or expense recognized in ~~other comprehensive income-net assets/equity~~ relating to a non-current asset (or disposal group) classified as held for sale.

- 39 If the disposal group is a newly acquired ~~subsidiary-controlled entity~~ that meets the criteria to be classified as held for sale on acquisition (see paragraph 11), disclosure of the major classes of assets and liabilities is not required.
- 40 An entity shall not reclassify or re-present amounts presented for non-current assets or for the assets and liabilities of disposal groups classified as held for sale in the statements of financial position for prior periods to reflect the classification in the statement of financial position for the latest period presented.

## Additional disclosures

- 41 An entity shall disclose the following information in the notes in the period in which a non-current asset (or disposal group) has been either classified as held for sale or sold:
- (a) ~~A~~ description of the non-current asset (or disposal group);
  - (b) ~~A~~ description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal;
  - (c) ~~T~~he gain or loss recognized in accordance with paragraphs 20–22 and, if not separately presented in the statement of ~~comprehensive income changes in net assets/equity~~, the caption in the statement of ~~changes in net assets/equity comprehensive income~~ that includes that gain or loss;
  - (d) ~~I~~f applicable, the ~~reportable~~ segment in which the non-current asset (or disposal group) is presented in accordance with ~~IFRS-IPSAS 18 Operating-Segment Reporting~~~~Reporting~~.
- 42 If either paragraph 26 or paragraph 29 applies, an entity shall disclose, in the period of the decision to change the plan to sell the non-current asset (or disposal group), a description of the facts and circumstances leading to the decision and the effect of the decision on the results of operations for the period and any prior periods presented.

## Transitional provisions

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- 43 The ~~IFRS-IPSAS~~ shall be applied prospectively to non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after the effective date of the ~~IFRS-IPSAS~~. An entity may apply the requirements of the ~~IFRS-IPSAS~~ to all non-current assets (or disposal groups) that meet the criteria to be classified as held for sale and operations that meet the criteria to be classified as discontinued after any date before the effective date of the ~~IFRS-IPSAS~~, provided the valuations and other information needed to apply the ~~IFRS-IPSAS~~ were obtained at the time those criteria were originally met.

## Effective date

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- 44 An entity shall apply this ~~IFRS-IPSAS~~ for annual periods beginning on or after 1 January ~~2005~~~~20XX~~. Earlier application is encouraged. If an entity applies the ~~IFRS-IPSAS~~ for a period beginning before 1 January ~~2005~~~~20XX~~, it shall disclose that fact.
- ~~44A IAS 1 (as revised in 2007) amended the terminology used throughout IFRSs. In addition it amended paragraphs 3 and 38, and added paragraph 33A. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies IAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.~~
- ~~44B IAS 27 Consolidated and Separate Financial Statements (as amended in 2008) added paragraph 33(d). An entity shall apply that amendment for annual periods beginning on or after 1 July 2009. If an entity applies IAS 27 (amended 2008) for an earlier period, the amendment shall be applied for that earlier period. The amendment shall be applied retrospectively.~~
- ~~44C Paragraphs 8A and 36A were added by Improvements to IFRSs issued in May 2008. An entity shall apply those amendments for annual periods beginning on or after 1 July 2009. Earlier application is permitted. However, an entity shall not apply the amendments for annual periods beginning before 1 July 2009 unless~~

it also applies IAS 27 (as amended in January 2008). If an entity applies the amendments before 1 July 2009 it shall disclose that fact. An entity shall apply the amendments prospectively from the date at which it first applied IFRS 5, subject to the transitional provisions in paragraph 45 of IAS 27 (amended January 2008).

- 44D — Paragraphs 5A, 12A and 15A were added and paragraph 8 was amended by IFRIC 17 *Distributions of Non-cash Assets to Owners* in November 2008. Those amendments shall be applied prospectively to non-current assets (or disposal groups) that are classified as held for distribution to owners in annual periods beginning on or after 1 July 2009. Retrospective application is not permitted. Earlier application is permitted. If an entity applies the amendments for a period beginning before 1 July 2009 it shall disclose that fact and also apply IFRS 3 *Business Combinations* (as revised in 2008), IAS 27 (as amended in January 2008) and IFRIC 17.
- 44E — Paragraph 5B was added by *Improvements to IFRSs* issued in April 2009. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 January 2010. Earlier application is permitted. If an entity applies the amendment for an earlier period it shall disclose that fact.
- 44F — [Deleted]
- 44G — IFRS 11 *Joint Arrangements*, issued in May 2011, amended paragraph 28. An entity shall apply that amendment when it applies IFRS 11.
- 44H — IFRS 13 *Fair Value Measurement*, issued in May 2011, amended the definition of fair value in Appendix A. An entity shall apply that amendment when it applies IFRS 13.
- 44I — *Presentation of Items of Other Comprehensive Income* (Amendments to IAS 1), issued in June 2011, amended paragraph 33A. An entity shall apply that amendment when it applies IAS 1 as amended in June 2011.
- 44J — [Deleted]
- 44K — IFRS 9, as issued in July 2014, amended paragraph 5 and deleted paragraphs 44F and 44J. An entity shall apply those amendments when it applies IFRS 9.
- 44L — *Annual Improvements to IFRSs 2012–2014 Cycle*, issued in September 2014, amended paragraphs 26–29 and added paragraph 26A. An entity shall apply those amendments prospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* to changes in a method of disposal that occur in annual periods beginning on or after 1 January 2016. Earlier application is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.
- 44M — IFRS 17, issued in May 2017, amended paragraph 5. An entity shall apply that amendment when it applies IFRS 17.

## **Withdrawal of IAS 35**

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- 45 — This IFRS supersedes IAS 35 *Discontinuing Operations*.

## Appendix A Defined terms

This appendix is an integral part of the *IFRS/IPSAS*.

<b>cash-generating unit</b>	The smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.
<b>component of an entity</b>	Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.
<b>costs to sell</b>	The incremental costs directly attributable to the disposal of an asset (or <b>disposal group</b> ), excluding finance costs <del>and income tax expense</del> .
<b>current asset</b>	An entity shall classify an asset as current when: <ul style="list-style-type: none"> <li>(a) <del>I</del>t expects to <del>realiz</del>se the asset, or intends to sell or consume it, in its normal operating cycle;</li> <li>(b) <del>I</del>t holds the asset primarily for the purpose of trading;</li> <li>(c) <del>I</del>t expects to <del>realiz</del>se the asset within twelve months after the reporting period; or</li> <li>(d) <del>T</del>he asset is cash or a cash equivalent (as defined in <i>IPSAS 27</i>) unless the asset is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting period.</li> </ul>
<b>discontinued operation</b>	A <b>component of an entity</b> that either has been disposed of or is classified as held for sale and: <ul style="list-style-type: none"> <li>(a) <del>R</del>epresents a separate major line of <del>business operations</del> or geographical area of operations,</li> <li>(b) <del>I</del>s part of a single <del>co-ordinated</del>coordinated plan to dispose of a separate major line of <del>business operations</del> or geographical area of operations or</li> <li>(c) <del>I</del>s a <del>subsidiary-controlled entity</del> acquired exclusively with a view to resale.</li> </ul>
<b>disposal group</b>	A group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction. The group includes goodwill acquired in a <del>business-public sector</del> combination if the group is a <b>cash-generating unit</b> to which goodwill has been allocated in accordance with the requirements of paragraphs <del>980–90H87</del> of <i>IPSAS 236 Impairment of Cash-Generating Assets (as revised in 2004)</i> or if it is an operation within such a cash-generating unit.
<b>fair value</b>	<i>Fair value</i> is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See <i>IFRS-IPSAS XX, Measurement-XX13</i> .)
<b>firm purchase commitment</b>	An agreement with an unrelated party, binding on both parties and usually legally enforceable, that (a) specifies all significant terms, including the price and timing of the transactions, and (b) includes a disincentive for non-performance that is sufficiently large to make performance <b>highly probable</b> .
<b>highly probable</b>	Significantly more likely than <b>probable</b> .
<b>non-current asset</b>	An asset that does not meet the definition of a <b>current asset</b> .
<b>probable</b>	More likely than not.
<b>recoverable amount</b>	The higher of an asset's <b>fair value</b> less <b>costs to sell</b> and its <b>value in use</b> .
<b>value in use</b>	The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

## Appendix B

### Application supplement

This appendix is an integral part of the ~~IFRS~~IPSAS.

#### Extension of the period required to complete a sale

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- B1 As noted in paragraph 9, an extension of the period required to complete a sale does not preclude an asset (or disposal group) from being classified as held for sale if the delay is caused by events or circumstances beyond the entity's control and there is sufficient evidence that the entity remains committed to its plan to sell the asset (or disposal group). An exception to the one-year requirement in paragraph 8 shall therefore apply in the following situations in which such events or circumstances arise:
- (a) ~~A~~at the date an entity commits itself to a plan to sell a non-current asset (or disposal group) it reasonably expects that others (not a buyer) will impose conditions on the transfer of the asset (or disposal group) that will extend the period required to complete the sale, and:
    - (i) ~~A~~ctions necessary to respond to those conditions cannot be initiated until after a *firm purchase commitment* is obtained, and
    - (ii) ~~A~~ firm purchase commitment is highly probable within one year.
  - (b) ~~a~~An entity obtains a firm purchase commitment and, as a result, a buyer or others unexpectedly impose conditions on the transfer of a non-current asset (or disposal group) previously classified as held for sale that will extend the period required to complete the sale, and:
    - (i) ~~T~~imely actions necessary to respond to the conditions have been taken, and
    - (ii) ~~a~~ favourable resolution of the delaying factors is expected.
  - (c) ~~d~~During the initial one-year period, circumstances arise that were previously considered unlikely and, as a result, a non-current asset (or disposal group) previously classified as held for sale is not sold by the end of that period, and:
    - (i) ~~d~~uring the initial one-year period the entity took action necessary to respond to the change in circumstances,
    - (ii) ~~t~~he non-current asset (or disposal group) is being actively marketed at a price that is reasonable, given the change in circumstances, and
    - (iii) ~~t~~he criteria in paragraphs 7 and 8 are met.

**Appendix C – Task Force Issues Papers****Purpose**

1. Task Force papers are provided to the IPSASB for informational purposes only.
2. Task Force papers were provided in order to support the understanding of the process followed by the Task Force and the conclusions reached.

**Task Force Issues Papers**

3. See links below for access to Task Force Papers.
  - (a) [Issue 1 – Definition of Transaction Costs](#)
  - (b) [Issue 2 – Transaction Costs – Approach](#)
  - (c) [Issue 3 – Accounting for Transaction Costs](#)
  - (d) [Issue 4 – Review of Chapter 3 \(Transaction Costs\)](#)
  - (e) [Issue 5 – Applicability of IFRS 5 in the Public Sector](#)
  - (f) [Issue 6 – Measuring Assets Held for Sale](#)
  - (g) [Issue 7 – Market Value vs Fair Value](#)

# Task Force Teleconference #1 – Measurement

January 30<sup>th</sup>, 2019

UTC-time	Toronto	Toyko	London	Panama	Rome
Wed Jan 30 <sup>th</sup> , 2019 at 12:00	Mon 7:00 AM	Mon 9:00 PM	Mon 12:00 PM	Mon 7:00 AM	Mon 1:00 PM

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Local dial-in number (Italy):	800-792-107
Conference ID:	23719107

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## Task Force Members:

*David Watkins*                      *Task Force Chair*  
*Aracelly Mendez*  
*Francesco Capalbo*  
*Stuart Barr*  
*Takeo Fukiya*  
*David Tretton*

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## Agenda:

Agenda Item	Presenter	Time
<b>1. Overview from Task Force Chair</b>	<b>David Watkins</b>	<b>5 Minutes</b>
1.1. Objective of the teleconference		
1.2. Outline protocol for the teleconference		
<b>2. <a href="#">Issue 1 – Definition of Transaction Costs</a></b>	<b>Dave Warren</b>	<b>15 Minutes</b>
2.1. Issue to be introduced by staff		
2.2. Obtain comments/views from the Task Force		
<b>3. <a href="#">Issue 2 – Transaction Costs - Approach</a></b>	<b>Dave Warren</b>	<b>10 Minutes</b>
3.1. Issue to be introduced by staff		
3.2. Obtain comments/views from the Task Force		
<b>4. <a href="#">Issue 3 – Accounting for Transaction Costs</a></b>	<b>Dave Warren</b>	<b>15 Minutes</b>
4.1. Issue to be introduced by staff		
4.2. Obtain comments/views from the Task Force		
<b>5. Next steps</b>	<b>Dave Warren</b>	<b>5 Minutes</b>
<b>6. Any other matters/comments</b>	<b>Task Force</b>	<b>5 Minutes</b>

## Definition of Transaction Costs

### Question

1. Can we develop a definition of transaction costs that is universal across all IPSAS?

### Detail

2. Accounting for transaction costs can be a contentious issue. The issue this task force will have to address is whether to capitalize or expense the transaction costs as they relate to a particular transaction.
3. However, prior to evaluating the accounting, staff is of the view the task force must first:
  - (a) Agree on what constitutes a transaction cost (i.e. the definition); and
  - (b) Whether this definition is applicable to all transactions (i.e. are transaction costs the same for PP&E as for FIs).

### Staff's recommendation

4. The existing definition in Chapter 4 of the Measurement Consultation Paper is:

*Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of an asset or liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the asset or liability.*
5. Staff recommends continuing to apply this definition while providing clarity in how it should be interpreted.

### Analysis

6. The existing definition is consistent with the definition of transaction costs in IPSAS 41, *Financial Instruments* (and IPSAS 29). The concept is also largely consistent with the concept put forward in International Valuation Standards (IVS) and Government Finance Statistics (GFS):
  - (a) IVS - Costs of purchase by either party as a direct result of the transaction.
  - (b) GFS - Costs associated with acquiring and disposing of nonfinancial assets.See [Appendix A](#) for definitions.
7. Both the GFS and IVS definitions are focused on the transaction costs associated with the purchase/ownership of an asset. While the task force needs to consider both assets and liabilities, staff believes a useful clarification of the existing CP definition is to highlight the GFS interpretation that transaction costs are costs of ownership transfer and the IVS interpretation that they are a direct result of the transaction.
  - (a) For assets – cost to transfer ownership

On the acquisition of an asset, an entity may be required to incur addition costs to transfer the ownership of the item. Transaction costs represent costs that are required in order to transfer ownership and to bring the asset to its present location and condition. Transaction costs may include:

- fees and commissions paid to agents, advisers, brokers and dealers;
- levies by regulatory agencies and securities exchanges;
- transfer taxes and duties;
- credit assessment fees;
- trade and transport costs separately invoiced to the purchaser;
- delivery and installation or removal costs not included in the price of the asset being acquired or disposed of;
- registration charges; and
- similar costs.

In some cases transaction costs are embedded in the price of the item. For example, Government A is constructing a public works project which requires a significant amount of concrete. The Government can acquire the concrete from Company Y for CU100,000 and take delivery at the public works site, or acquire the concrete from Company Z for CU90,000 and take delivery of the product at the offices of Company Z. Acquiring the concrete from Company Z requires incurring additional transportation costs, while acquiring the product from Company Y has the transportation costs embedded in the price. Regardless, the transportation costs represent a transaction cost in this scenario as they are required to be incurred to bring the product to its current location.

(b) For liabilities – cost to extinguish the obligation

When extinguishing a liability, an entity may be required to incur costs to settle or transfer the obligation. Transaction costs represent costs that are required to settle or extinguish the obligation. Transaction costs may include:

- fees and commissions paid to agents, advisers, brokers and dealers;
- levies by regulatory agencies and securities exchanges;
- transfer taxes and duties; and
- similar costs.

8. Interpreting transaction costs as costs required to be incurred eliminates ancillary costs such as borrowing costs and overdue fines because:

- (a) Borrowing costs do not need to be incurred to acquire assets. Financing does not impact the value of the asset.
- (b) Overdue fines, or past due fees, are charged against an organization for paying the liability after the due date. These are avoidable and are not required to be incurred.

NOTE –Borrowing costs are excluded from transaction costs. The treatment of borrowing costs is raised in a separate chapter in the CP.

9. Staff is of the view, with additional interpretive guidance, as outlined in paragraphs 7 – 8, the existing definition of transaction costs is appropriate for all IPSAS (i.e. transactions costs to acquire PP&E are the same as those for the acquisition of a financial asset).

## Additional options for discussion

10. In developing staff's recommendation, alternatives considered include:

- (a) Transaction costs are not universal across all transactions and should be dealt with on a standard by standard basis

Pro – guidance specific to individual transactions can be developed and included in the standard to which it is the most applicable. This creates a “one stop” location for all guidance when accounting for a particular transaction.

Con – pushing measurement guidance out to individual standards, in this case transaction costs, seems to go against the objective of the project. At the CP stage we should be ambitious.

- (b) Be silent on transaction costs and allow the application of the principles to develop in practice

Pro – by allowing professional judgement to determine how transaction costs should be measured, those who are closest to the transaction and have the best understanding of the transaction will assess the most appropriate way to reflect the costs to the financial statement user.

Con – given the objective of the project is to clarify existing measurement guidance in the conceptual framework, it seems odd to turn away from this goal at the CP stage. Furthermore, existing confusion is not eliminated and diversity in practice will occur.

## Decision required

Does the Task Force agree with staff's recommendation?

## APPENDIX A – GUIDANCE (FOR INFORMATIONAL PURPOSES ONLY)

*IVS 2017, IVS 104, 210.1*

The seller's costs of sale or the buyer's costs of purchase and any taxes payable by either party as a direct result of the transaction.

*GFSM 2014 glossary, 8.6*

Costs of ownership transfer are the costs associated with acquiring and disposing of nonfinancial assets (other than inventories).

(SNA 2008, 10.51) Costs of ownership transfer - The costs of ownership transfer consist of the following kinds of items

- (i) All professional charges or commissions incurred by both units acquiring or disposing of an asset such as fees paid to lawyers, architects, surveyors, engineers and valuers, and commissions paid to estate agents and auctioneers.
- (ii) Any trade and transport costs separately invoiced to the purchaser,
- (iii) All taxes payable by the unit acquiring the asset on the transfer of ownership of the asset.
- (iv) Any tax payable on the disposal of an asset.
- (v) Any delivery and installation or disinstallation costs not included in the price of the asset being acquired or disposed of.
- (vi) Any terminal costs incurred at the end of an asset's life such as those required to render the structure safe or to restore the environment in which it is situated.

*IFRS 13 (Appendix A)*

The costs to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability that are directly attributable to the disposal of the asset or the transfer of the liability and meet both of the following criteria:

- (a) They result directly from and are essential to that transaction.
- (b) They would not have been incurred by the entity had the decision to sell the asset or transfer the liability not been made.

*IPSAS 29.10 (IPSAS 41.9)*

Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

### Transaction Costs - Approach

#### Question

1. Where should the guidance on transaction costs be located within the IPSAS literature?

#### Detail

2. This issues paper assumes the Task Force reached consensus on how transaction costs should be defined and the definition applies equally to all IPSAS (See [Issues Paper 1](#)).
3. The task force must now determine how the CP should propose addressing transaction costs within the IPSAS framework. This does not relate to how to account for transaction costs (see [Issues Paper 3](#)), but where the guidance should be located.

#### Staff's recommendation

4. Staff recommends transaction costs are addressed in the measurement standard.

#### Analysis

5. Staff has identified a number of options in where the guidance on transaction costs can be located within the IPSAS literature. These options include:
  - (a) Option 1 – Address in the measurement standard (each measurement basis appendix would state the accounting for transactions costs for that measurement basis (i.e. the historical cost appendix would state the transaction costs requirements with IPSAS 17, PP&E, only stating PP&E is measured at cost).

Pros – the objective of this project is to provide measurement guidance in one standard. Where principles can be developed that are applicable across all IPSAS, they should be developed in the measurement standard.

Cons - It is challenging for generic principles in the measurement standard to consider unique factors of each transaction type (PP&E vs Financial Instruments).
  - (b) Option 2 – Transaction costs are addressed IPSAS by IPSAS (IPSAS 17, PP&E, would require PP&E be measured at cost and then state the accounting for transaction costs).

Pros – when transaction costs are addressed in each IPSAS, the accounting principles can be developed specific to each transaction. For example, addressing transaction costs in IPSAS 17 would allow for the specifics of PP&E to be considered.

Cons – the objective of the project was to address measurement issues in one standard. Assuming transaction costs are generic across all IPSAS, addressing the accounting in each IPSAS contradicts the mandate set by the IPSASB.
  - (c) Option 3 – Develop a universal principle (expense all transaction costs).

Pros – the advantage to developing a universal principle is the simplicity. Adopters of IPSAS would universally apply a principle when accounting for transaction costs, whether it be expense all transaction costs or capitalize all transaction costs.

Cons – developing a universal principle presents challenges in practice. While the definition of transaction costs may be consistent across all IPSAS, consistent accounting across all IPSAS may not help users make decisions. For example, when assets are held for sale, the price to acquire the asset is not useful (i.e. capitalizing transaction costs). Conversely,

# Issues Paper

## 2

when assets are held for service, the sales price is not relevant (i.e. expensing transaction costs).

6. Staff supports Option 1 - *Address in the measurement standard*. As will be discussed in [Issues Paper 3](#), staff is of the view whether transaction costs are capitalized or expensed is dependent on the objective of the measurement basis, not the individual transactions. For example, whether transaction costs are included in measuring PP&E is related to the information the financial statement user needs, as opposed to the transaction being a PP&E transaction. As such, staff is of the view measurement principles for all transactions costs can be addressed in one measurement standard.

### **Decision required**

Does the Task Force agree with staff's recommendation?

### Accounting for Transaction Costs

#### Question

1. How should transaction costs be accounted within each measurement basis.

#### Detail

2. The key issue this task force has to address is how transaction costs should be accounted for. The task force must address whether transaction costs should be included in the carrying value of the financial statement item or expensed.

#### Staff's recommendation

3. Accounting for transaction costs should be determined by measurement basis. Staff is of the view whether transaction costs are capitalized or expensed is dependent on the measurement objective of the measurement basis.
4. Staff proposes transaction costs be:
  - (a) Expensed when the measurement objective is to determine an exit price; and
  - (b) Incorporated into the carrying amount when the measurement objective is to determine an entry price.
5. Based on the measurement objectives of the measurement bases, staff recommends accounting for transaction costs as follows:

Figure 1 – Accounting for Transaction Costs

Measurement Basis	Measurement Objective	Accounting for Transaction Costs
Cost of Fulfillment (Appendix 1)	Note 1	Note 1
Fair Value (Appendix 2)	Exit price	Exclude (expense)
Historical Cost (Appendix 3)	Entry price	Include (capitalize)
Replacement Cost (Appendix 4)	Entry price	Include (capitalize)

**Note 1** – staff requires input from the task force. CoF is the cost to settle/fulfill an obligation. This sounds like an exit price. However, staff is of the view costs directly related to settling the liability should be included in the valuation. Staff suggests an exit/entry concept is not applicable to liabilities.

#### Analysis

6. In evaluating how to account for transaction costs, staff took a step back and focused on the purpose of measurement for financial statement purposes. Staff concluded the purpose was to provide the user with information to inform their decision.

7. From this perspective, accounting for transaction costs is not dependent on the transaction itself (i.e. PP&E, inventory, etc.), but on the objective of measurement.
8. Staff is of the view when the measurement objective is to determine the:
  - (a) Price received to sell an asset/liability, transaction costs should be excluded from the carrying amount.

The price is an exit price or a market price. This purpose of this price is to provide users with information about how much the entity would receive to sell the asset or have to pay to extinguish the liability. As such, the costs to enter into the transaction are irrelevant.

For example, an entity acquires a parcel of land for CU100,000 and pays CU5,000 in transfer fees with the sole objective of selling the land in the foreseeable future. The transfer fees of CU5,000 is not useful information to the user of the financial statements. The user wants to know how much the asset can be sold for. In this simple example, it is CU100,000.
  - (b) Price of the asset/liability to the entity, transaction costs should be included in the carrying amount.

This is an entry price or a price specific to the entity. The purpose of this price is to provide users with information about the value of the asset or the liability to the entity. In this case, the transactions costs are relevant in valuation.

For example, an entity acquires a parcel of land for CU100,000 and pays CU5,000 in transfer fees with the sole objective of using the land in the production of agriculture. The transfer fees of CU5,000 are useful information to the user of the financial statements because they indicate the entity is of the view the productive value of the land is equal to or exceeds CU105,000.
9. Given the view accounting for transaction costs is associated with the measurement objective, staff recommends accounting for transaction costs depending on whether the measurement basis is an entry or exit value (see [Figure 1](#) above).
10. Staff performed an additional step back and is of the view the proposed accounting for transaction costs is consistent with the existing accounting treatment in IPSAS. While this was not an objective of the task force, it is a benefit of applying this approach.

### *Cost of fulfillment*

11. Staff requires insight from the task force in developing guidance for the cost of fulfillment measurement basis. In developing transaction costs guidance for the cost of fulfillment measurement basis, staff debated opposing views:
  - (a) Cost of fulfillment is an exit price – the cost of fulfillment is the price required to be paid to extinguish a liability, or exit the transaction. This suggests transaction costs should be excluded from the measurement basis.
  - (b) Cost of fulfillment is entity specific – the cost of fulfillment is the price required to be paid by the entity to extinguish a liability. This suggests all costs associated with extinguishment should be included in the measurement basis.
12. Staff further considered the concept of exit/entry pricing does not apply to liabilities as well as it does to assets.

13. Given this contradiction, staff appreciates any views the task force can provide.

**Decision required**

Does the Task Force agree with staff's recommendation?

## Task Force Teleconference #2 – Measurement

February 13<sup>th</sup>, 2019

UTC-time	Toronto	Tokyo	London	Panama	Rome
Wed Jan 30 <sup>th</sup> , 2019 at 12:00	Mon 7:00 AM	Mon 9:00 PM	Mon 12:00 PM	Mon 7:00 AM	Mon 1:00 PM

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### Task Force Members:

*David Watkins*                      *Task Force Chair*  
*Aracelly Mendez*  
*Francesco Capalbo*  
*Stuart Barr*  
*Takeo Fukiya*  
*David Tretton*

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### Agenda:

Agenda Item	Presenter	Time
<b>1. Overview from Task Force Chair</b>	<b>David Watkins</b>	<b>5 Minutes</b>
1.1. Objective of the teleconference		
<b>2. <a href="#">Issue 1 – Review of Chapter 3 (Transaction Costs)</a></b>	<b>Dave Warren</b>	<b>20 Minutes</b>
2.1. Chapter overview provided by staff		
2.2. Obtain comments/views from the Task Force		
<b>3. <a href="#">Issue 2 – Applicability of IFRS 5 in public sector</a></b>	<b>Edwin Ng</b>	<b>10 Minutes</b>
3.1. Issue to be introduced by staff		
3.2. Obtain comments/views from the Task Force		
<b>4. <a href="#">Issue 3 – Measuring Assets Held for Sale</a></b>	<b>Edwin Ng</b>	<b>10 Minutes</b>
4.1. Issue to be introduced by staff		
4.2. Obtain comments/views from the Task Force		
<b>5. <a href="#">Issue 4 – Market Value vs Fair Value</a></b>	<b>Dave Warren</b>	<b>5 Minutes</b>
5.1. Issue to be introduced by staff		
5.2. Obtain comments/views from the Task Force		
<b>6. Next steps</b>	<b>Dave Warren</b>	<b>5 Minutes</b>
<b>7. Any other matters/comments</b>	<b>Task Force</b>	<b>5 Minutes</b>

## Review of Chapter 3 – Transaction Costs

### Question

1. Does the Task Force agree their views have been appropriately reflected in Chapter 3 – Transaction Costs?

### Detail

2. The Task Force provided significant input in developing the transaction costs chapter on the January 30, 2018 teleconference. The following issues were discussed:

- (a) The definition of transaction costs;

Members agreed with the principle proposed. Members asked staff to consider:

- Transaction costs yet to be incurred (see paragraph [3.35\(a\)](#));
- Whether “incurred” is the most appropriate definition (is “additional” better); and
- The difference between the IFRS 13 and IFRS 9 transaction costs definition.

Staff has addressed the proposals put forward by the Task Force with additional interpretative guidance. In general, prioritized maintaining alignment with the IFRS definition where possible.

- (b) The location of the transaction costs guidance; and

Members agreed transaction costs guidance should be included in the Measurement guidance and address all IPSAS.

- (c) How to account for transaction costs.

Members agreed with the general principle that:

- Exit prices exclude transaction costs; and
- Entry prices include transaction costs in the measurement valuation.

Members provided suggestions on how to address accounting for transaction costs for the cost of fulfillment measurements basis. See [footnote 9](#). Staff anticipate further discussion from the Task Force on the February 13 teleconference.

### Instructions to the Task Force in their review of Chapter 3

3. Chapter 3 includes 3 sections:
  - (a) Using the Bases in Practice: relationship with IVSC and GFS (equivalence table)
  - (b) Borrowing Costs
  - (c) Transaction Costs
4. You have been provided Chapter 3 in its entirety. You are welcome to review the entire chapter, however, please focus your review on the last section of the chapter (beginning with paragraph [3.27](#)).
5. For the teleconference, let’s focus our discussion on section structure, principles and general comments. I will be happy to take any edits off line.

## **Decision required**

Does the Task Force support the Transaction Costs section of Chapter 3?

### Applicability of IFRS 5 in the Public Sector

#### Question

1. Does the Task Force agree that the measurement of assets held for sale should be addressed separately from the IPSASB measurement project?

#### Detail

2. In December, the IPSASB noted that IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations* (IFRS 5) is relevant for the public sector. The Board instructed the Task Force and staff to provide a recommendation for their consideration in March 2019 on whether this topic should be included as an additional appendix in ED, *Measurement*.

#### Analysis

3. IFRS 5 provides guidance on the following aspects of assets held for sale:
  - (a) *Classification* of non-current assets or disposal groups as held for sale or for distribution to owners;
  - (b) *Measurement* of non-current assets or disposal groups classified as held for sale; and
  - (c) Related *presentation and disclosure* requirements.
4. The guidance on measurement addresses what measurement basis to use for these assets – fair value less cost to sell or carrying amount – rather than how to calculate a measurement basis.
5. While what measurement basis to use for these assets is important in the public sector, because the guidance does not address how to calculate a measurement basis, it falls outside of the Illustrative ED's scope.

#### Recommendation

6. Staff recommend the following be proposed to the IPSASB:
  - (a) Guidance in IFRS 5 is relevant to the public sector and should be incorporated into IPSAS (not necessarily an alignment project);
  - (b) Guidance in IFRS 5 falls outside of the scope of the measurement project because it addresses the what and not the how; and
  - (c) Further analysis is required after March 2019.

Staff propose taking marked up version of IFRS 5, for public sector differences, to the Board in March. The recommendation to address IFRS 5 separately will be made, but this allows the Board an option to include the guidance in the Measurement CP/ED.

#### Decision required

7. Does the Task Force agree that the measurement of assets held for sale or disposal should be addressed separately from the IPSASB measurement project?

### Measurement of Assets Held for Sale in the Public Sector

#### Question

1. Does the Task Force agree further analysis is required as to whether fair value less cost to sell, as required by IFRS 5, is the appropriate measurement basis for assets held for sale in the public sector?

#### Detail

2. [Issues Paper 2](#) considers whether whether ED, *Measurement*, should included guidance on the assets held for sale. [Issues Paper 2](#) proposes the guidance is outside the scope of the measurement project and that further analysis is required.
3. That further analysis relates to whether fair value less costs to sell, as required by IFRS 5, is the appropriate measurement basis for assets held for sale in the public sector, and if not, whether another measurement bases, in particular net selling price, is more appropriate.

#### *Fair value less costs to sell appropriate when assets held for sale or disposal?*

4. IFRS 5 requires an asset held for sale or disposal to be measured at the lower of carrying amount and fair value less costs to sell. Fair value is defined in the ED, *Measurement*, as the price that would be received to sell the asset in an orderly transaction between market participants in the principal or most advantageous market at the measurement date.
5. Fair value may not be the most appropriate measurement basis for assets held for sale or disposal in the public sector given that such assets may often be specialized operational assets or heritage assets which do not have an active market. Furthermore, it may not be possible to determine these assets' highest and best use given their specialized nature.
6. When a public sector entity holds assets for sale or disposal, arguably it is their contribution to the entity's financial capacity which is the main concern. This suggests that net selling price is a more appropriate measurement basis to apply, given that it accounts for any constraints on sale and better reflects the expected amount that would be received by the entity on sale of the asset. Net selling price is also a measurement basis identified in the IPSASB's Conceptual Framework.

#### Recommendation

7. Given the potential differences in measurement outcomes, the appropriateness of each measurement basis (net selling price, fair value less costs to sell, and carrying amount) in different circumstances would be an important issue to address.
8. It is recommended that time be allocated after the March meeting to consider whether fair value less costs of sale is the appropriate measurement basis for assets held for sale in the public sector.

#### Decision required

9. Does the Task Force agree with the recommendation for staff to consider further which measurement basis is appropriate to apply in the public sector after the March 2019 IPSASB meeting.

### Market Value vs Fair Value

#### Question

1. How should staff address the similarities between the definition of Fair Value and Market Value?

#### Detail

2. As noted in the equivalence table in [Appendix A of Chapter 3](#), distinguishing between Fair Value and Market Value is challenging.
  - (a) Market value is defined in the conceptual framework as the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.
  - (b) Fair value is defined in the illustrative ED as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.
3. This similarity between the two definitions creates challenges in practice. Specifically, what is the difference between the two measurement bases.

#### Staff's recommendation

4. This is a challenging issue to manage. Staff struggle with identifying a path forward, and a way to close the issue, for the March IPSASB meeting.
5. Staff propose addressing the issue in the second phase of the measurement project, in conjunction with the limited scope review of the conceptual framework.
6. However, staff is interested in task force views – hopefully a brilliant idea – on how to proceed.

#### Analysis

7. Given the how similar the definitions of fair value and market value are, and the IPSASB's view that terms should be used consistently across the literatures, i.e., if we mean fair value, say fair value, staff have identified two options to pursue:
  - (a) Select one term to apply across IPSAS – either fair value or market value;  
This option presumes there is no difference between fair value and market value from a practical standpoint.
  - (b) Identify the difference between fair value and market value and differentiate accordingly across IPSAS  
This option presumes a tangible difference exists between fair value and market value and it is relevant to the public sector.

#### Decision required

Does the Task Force agree propose any additional options in addressing the similarities between fair value and market value?

### Chapter 3, How will the Illustrative ED need to be Developed Further?

- 3.1. This chapter discusses three areas relating to public sector measurement on which the IPSASB is specifically seeking input on from its constituents:
- (a) Using measurement bases in practice and the relationship of IPSAS with other, non-accounting guidance – in International Valuation Standards (IVS) issued by the International Valuation Standards Council (IVSC, and in the Government Finance Statistics (GFS) Manual;
  - (b) The accounting treatment of borrowing costs; and
  - (c) The accounting treatment of transaction costs.

#### Using the Bases in Practice: relationship with IVSC and GFS

- 3.2. In developing the Illustrative Exposure Draft, the IPSASB reviewed definitions relating to measurement in existing IPSAS and in IFRS 13 and compared these with equivalent definitions or descriptions in IVS and GFS. In particular, the IPSASB considered whether there were concepts in IVS and GFS that may need to be incorporated into IPSAS.
- 3.3. The equivalence table, included in [Appendix A](#) to this chapter, suggests that there is a broad equivalence between IPSAS, IVS and GFS in the discussion of Fair Value and Replacement Cost, which are the two measurement bases for which Application Guidance has been drafted in the Illustrative Exposure Draft. There also appears to be some equivalence between the net selling price measurement basis and an IVS Liquidation Value, and between the IPSAS concept of value in use and an IVS Investment Value. The IPSASB will explore these further during the next phase of the measurement project, The IVS valuation approaches of Equitable Value and Synergistic Value may have some relevance to the public sector and will also be examined in the next phase of the project. The IPSASB would welcome any views that constituents might have on these apparent similarities between the three sources of guidance.

#### Borrowing Costs

##### Capitalization or Expensing of Borrowing Costs

- 3.4. IPSAS 5, *Borrowing Costs*, defines borrowing costs as interest and other expenses incurred by an entity in connection with the borrowing of funds. It generally requires the immediate expensing of borrowing costs. However, it permits, as an allowed alternative treatment, the capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.
- 3.5. Borrowing costs may be attributable to the initial acquisition of the asset, but are not part of the asset's purchase price or, in the case of construction or production, the prices of material and labor. They are not a characteristic of the asset being valued. They are entity-specific costs, which depend on the entity's financing choices.
- 3.6. The question of how to account for borrowing costs also applies to subsequent measurement, when an entity revalues assets applying a cost-based estimate such as replacement cost. IPSAS application guidance does not address the issue of whether, and if so, how, borrowing costs should be incorporated into the calculation of a cost-based current value.
- 3.7. This section addresses these challenges and proposes a way forward in order to address the accounting for borrowing costs in practice.

**Public Sector Borrowing**

- 3.8. The IPSASB considers that there are significant differences between borrowing in the public and private sectors.
- 3.9. Borrowing in the public sector is often centralized and borrowing requirements are determined for the economic entity as a whole. For example, a national government often borrows on behalf of all of its subsidiary entities, including government departments, hospitals, schools and entities responsible for construction of buildings and infrastructure. While centralized borrowing also occurs in the private sector, the public sector approach is different: borrowing may be for investing activities or, in a situation where governments may budget for a deficit, for financing or operating activities.
- 3.10. Furthermore, governments often borrow at a level to fund their aggregate activities. Meaning, borrowings are not attributable to a specific expenditure. Funding allocated to specific programs and entities may be derived from a variety of sources, and consequently it is often difficult to determine whether the acquisition/construction/production of an asset has been financed through external borrowing or from other sources. Thus, there is often no meaningful way to attribute borrowing costs to qualifying assets.
- 3.11. However, there are situations where public sector entities borrow specifically to finance capital projects. For example, local governments such as city and district councils may finance their construction of infrastructure (roads, bridges, etc.) through specific external borrowing. In these situations public sector entities are able to attribute borrowing costs to a qualifying asset. Similarly an international development bank such as the World Bank or the European Investment Bank may finance part or all of the construction of a particular infrastructure project undertaken by a public sector entity.

**Options for Treatment of Borrowing Costs**

- 3.12. The IPSASB has identified four options for treatment of borrowing costs for a qualifying asset during the period between the start of acquisition/construction/production and active use, as shown in Table 1 below.

**Table 1: Treatment of Borrowing Costs: Options**

<b>Borrowing costs—<i>acquisition, construction or production of qualifying asset:</i></b>	<b>Option 1</b>	<b>Option 2 (IFRS)</b>	<b>Option 3</b>	<b>Option 4 (GFS)</b>
Directly attributable ► and specifically incurred	Expense or capitalize	Must capitalize	Expense or capitalize	Expense
Directly attributable ► but not specifically incurred	Expense or capitalize	Must capitalize	Expense	Expense
<b>Borrowing costs—<i>interest and other expenses incurred by an entity in connection with the borrowing of funds.</i></b>	Expense	Expense	Expense	Expense

- 3.13. Option 1 is the status quo, and would mean no change to IPSAS 5. This option allows for an entity to choose either to capitalize or expense borrowing costs that are directly attributable to a qualifying asset during its acquisition, construction or production. Direct attribution could involve, for example,

a formula to estimate the fraction of borrowing that logically applies to asset construction activities, as opposed to other operations.

- 3.14. Option 2, which aligns with IAS 23, requires capitalization and removes the choice to expense. Capitalization applies only during acquisition, construction or production of the qualifying asset, and the borrowings costs must be directly attributable.
- 3.15. Option 3 requires that the accounting policy choice for capitalization only apply to those borrowing costs that are *both* directly attributable to, *and specifically incurred* for, acquisition, construction or production of a qualifying asset. A choice remains, although the extent of choice is narrower than is the case under Option 1.
- 3.16. Option 4 requires that all borrowing costs, without exception, be expensed and is aligned with GFS.

### Discussion of the Four Options

#### *Objective of Measurement*

- 3.17. The objective of measurement is to select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes<sup>2</sup>.
- 3.18. Capitalizing borrowing costs applies the time value of money principle to the purchase of assets that take a substantial period of time to get ready prior to use. For example, if an entity were to purchase an asset today for CU100, and it will be ready for use in one year, deferring the payment until the asset is ready for use would require a larger payment as a currency unit today is not worth the same as a currency unit tomorrow. Applying that principle supports including borrowing costs in the value of the asset as they approximate the amount that would have been paid, had the payment been deferred until the asset is ready for use. Furthermore, capitalization of borrowing costs ensures that expenses are allocated to the reporting period in which they occur, i.e. expensed as the economic benefits and/or service potential of the qualifying asset is consumed. The capitalization accounting policy will, applying this reasoning, better support assessment of the cost of services.
- 3.19. Option 1-3's approach to capitalizing borrowing costs allows an entity to link costs to the asset for which borrowing was incurred. Some argue that this provides useful information for accountability and decision making. If the amount of interest that has been capitalized is disclosed in the notes to the financial statements then users are still able to calculate the total interest costs for the period.
- 3.20. However, capitalization of borrowing costs increases the amount recognized as an asset. Yet there appears to be no relationship between an asset's future economic benefits and/or service potential and the extent of borrowing costs incurred. Therefore, capitalization of borrowing costs appears to incorrectly convey to users of the financial statements that assets financed through borrowing have more service potential or ability to generate economic benefits compared to similar assets held by an entity that does not use debt to finance its asset acquisitions. Capitalization has the result that users of the financial statements may assess an entity's operational capacity and financial capacity as higher than would be the case if no capitalization occurred. With respect to the cost of services, capitalization of borrowing costs defers costs to future periods.
- 3.21. If all borrowing costs are expensed then the interest cost item in the entity's statement of financial performance allows users to see a government's total borrowing cost, with no amount "hidden" in

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<sup>2</sup> Paragraph 7.2 of the Conceptual Framework.

assets. Those users of the financial statements that consider total interest costs to be an important indicator of financial performance will likely prefer Option 4, because it provides them with useful information to hold the entity to account and for decision-making purposes.

#### *Public Sector Differences*

- 3.22. Where possible the Board has a policy to align with guidance developed by the IASB. However, in circumstances where a public sector difference are identified, departure is considered necessary. As paragraph 3.21 supports expensing borrowing costs from a conceptual perspective, the Board is of the view departure from IFRS is further justified in light of the public sector differences identified:
- (a) In the public sector, borrowing is often centralized and is determined for the economic entity as a whole. This creates challenges in allocating borrowing costs when they are not incurred directly by the entity constructing or developing the asset. Furthermore, the borrowing rate reflects the risks associated with the group entity and not those specific to the specific entity.
  - (b) As outlined in paragraph 3.11 above, debt funding is rarely specific to the construction or development of an individual asset. Borrowings are used to fund the activities of the government, one of which is the construction of the asset. As the borrowing is not specific to the asset, funding for the asset comes from a variety of sources which include tax revenues, service fees, debt, etc. Allocating a portion of the borrowings to the asset can therefore be an arbitrary exercise.
- 3.23. While it may be feasible to allocate these borrowings to qualifying assets, the Board is of the view that doing so is unlikely to provide relevant and represent faithful information as allocation would be arbitrary. Any accounting system used to track directly attributable borrowing costs and their application to qualifying assets is likely to be complex and resource intensive. The Board is of the view that the complexity would mean that the costs incurred in capitalizing borrowing costs would be considerable and likely to exceed the related benefits.

#### **Preliminary View—Expense All Borrowing Costs**

- 3.24. The IPSASB noted that requiring, or allowing, entities to capitalize borrowing costs impacts the carrying amount of the asset depending on how an entity decides to finance the purchase. Capitalizing borrowing costs increases the carrying amount of the asset beyond the cost to acquire or develop the asset.
- 3.25. The IPSASB considers that requiring or permitting public sector entities to capitalize borrowing costs do not support achievement of the qualitative characteristics. In particular, capitalizing borrowing costs appears likely to diminish the comparability of information in the financial statements. Given the extent to which judgement is needed for Options 1 to 3, the IPSASB does not consider that these three options would contribute significantly towards achievement of the objectives of financial reporting. The IPSASB considers that, having regard to the constraints, expensing borrowing costs (Option 4) will provide more useful information for users' assessments of entities' operational capacity, financial capacity and cost of services. Option 4 will also align borrowing cost measurement under IPSAS with GFS reporting guidelines.
- 3.26. Therefore, the IPSASB's preliminary view is that all borrowing costs should be expensed.

**Preliminary View—Chapter 3.1**

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 provide your reasons, the other option that you support instead, and your reasons for supporting that other option.

**Transaction Costs**

3.27. This section addresses two common challenges public sector entities encounter when accounting for transaction costs:

- (a) Whether the cost meets the definition of a transaction cost; and
- (b) Whether the transaction cost should be included or excluded in the carrying value of the financial statement item.

3.28. Since IPSAS do not provide an explicit conceptual basis for its different accounting treatments of transaction costs, the Board concluded there is scope to improve how IPSAS addresses this.

*Transaction Costs - Definition*

3.29. Although the treatment of transaction costs is addressed in several IPSAS (e.g. IPSAS 12, 16, 17, 27 and 31), these IPSAS refer to such costs using different phrases, and generally do not call them ‘transaction costs’. IPSAS lacks a general definition of transaction costs, to ensure a consistent meaning for transaction costs across all IPSAS, while also supporting the understandability of IPSAS.

3.30. The only tangible definition exists in IPSAS 41, Financial Instruments<sup>3</sup>. IPSAS 41 defines transaction costs as:

Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

3.31. In considering the applicability of this definition across all IPSAS, the Board considered whether the definition was consistent with concepts developed by comparable global organizations. In doing so the Board compared the definitions applied in International Valuation Standards (IVS), Governmental Finance Statistics (GFS) and International Financial Reporting Standards (IFRS) to evaluate the consistency of those definitions with the existing IPSAS definition in IPSAS 41.

IFRS	IVS	GFS
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<sup>3</sup> Paragraph 9, IPSAS 41

<p>The costs to sell an asset or transfer a liability in the principal (or most advantageous) market for the asset or liability that are directly attributable to the disposal of the asset or the transfer of the liability and meet both of the following criteria:</p> <p>(a) They result directly from and are essential to that transaction.</p> <p>(b) They would not have been incurred by the entity had the decision to sell the asset or transfer the liability not been made.</p> <p>(IFRS 13, Appendix A)</p>	<p>The seller's costs of sale or the buyer's costs of purchase and any taxes payable by either party as a direct result of the transaction (IVS 2017, IVS 104, 210.1)</p>	<p>Costs of ownership transfer are the costs associated with acquiring and disposing of nonfinancial assets (other than inventories). (GFSM 2014 glossary, 8.6)</p>
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- 3.32. While the GFS and IVS definitions consider transaction costs from the perspective of an asset, they, as well as the IFRS definition, highlight that transaction costs are a direct result of the transaction – this concept is evidenced in the GFS definition through the cost of ownership transfer.
- 3.33. As the IPSAS 41 definition incorporates the core concept put forward in the IFRS, GFS and IVS definitions of transaction costs, the Board concluded it was appropriate to amend the IPSAS 41 definition of transaction costs to make it applicable to all IPSAS.
- 3.34. In amending the IPSAS 41 definition of transaction costs to make it applicable to all IPSAS, references to financial instruments were removed and replaced with generic asset and liability terms. As such transaction costs are defined as:

Incremental costs that are directly attributable to the acquisition, issue or disposal of an asset or liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the asset or liability.

#### Incremental Interpretation Guidance

- 3.35. To support consistent interpretation in practice, additional interpretive guidance is included in the Illustrative Exposure Draft. It clarifies the proposed definition of transaction costs by including key GFS, IVS and IFRS concepts:
- (a) IFRS – costs to transact in the principal, or most advantageous, market
- Incremental costs are often incurred when entering into a transaction. However, in circumstances where an asset or liability is being measured and no transaction has taken place, for example when the replacement costs of an asset is being measured at a point subsequent to initial recognition, transaction costs will have to be assumed as they have not been incurred. This is also the case when incremental costs will be incurred to exit a transaction, for example costs to sell an asset or costs that may be incurred to close a financing facility, such as a line of credit. When transaction costs are to be estimated, they are assumed to be incurred in the principal, or most advantageous, market- that is, the market with the

greatest volume and level of activity for the asset or liability, or when a principal market does not exist, the market that maximizes the amount that would be received to sell the asset or minimizes the amount that would be paid to transfer the liability.

(b) IVS – direct result of the transaction

Incremental costs are a direct result of the transaction. Transaction costs are an essential feature of the transaction, and they would not have been incurred had the transaction not occurred. For example, costs to operate an asset after it has been acquired could be described as incremental costs because they would not be incurred if the entity had not acquired the asset. However, by clarifying that transaction costs are an essential feature of the transaction itself, operating costs are excluded from the definition of transaction costs.

(c) GFS – cost of ownership transfer

Costs attributable to the acquisition of an asset relate specifically to costs of ownership transfer. Costs incurred prior to transfer (for example, costs to negotiate the transaction), or costs incurred subsequent to the transfer, (for example, borrowing costs), are excluded from the definition of transaction costs.<sup>4</sup>

### Preliminary View—Chapter 3.2

Transaction costs in the public sector are defined as follows:

**Transaction costs** are incremental costs that are directly attributable to the acquisition, issue or disposal of an asset or liability. An incremental cost is one that 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, the other option that you support instead, and your reasons for supporting that other option.

#### *Location of Guidance*

3.36. During its review of transaction costs, the Board concluded that, whatever its final view on the treatment of transaction costs, the application guidance in IPSAS, Measurement, and requirements in other IPSASs will need to be coordinated. Otherwise, transaction costs could either be added twice or subtracted twice as a result of the same requirement appearing in both IPSAS, Measurement, and another IPSAS.

3.37. In determining the most appropriate method and location to address transaction costs, the Board consider four options:

- (d) Option 1 – transaction costs are addressed in the measurement IPSAS (i.e., principles for accounting for transaction costs would be outlined for each measurement basis);
- (e) Option 2 – accounting for transaction costs is addressed in individual IPSAS;
- (f) Option 3 – IPSAS would become silent on the accounting for transaction costs;

<sup>4</sup> Whether the examples provided are included in the measurement of the asset or liability is outside the scope of this section.

- (g) Option 4 – Develop a universal principle to be applied across all IPSAS (e.g., exclude all transaction costs from the measurement of the asset or liability).
- 3.38. The Board noted there are benefits associated with pursuing each option. However, the Board noted a significant challenge existed in developing a universal principle for all IPSAS; the measurement objective differs in each standard, and in some cases even within the standard. For example, if the measurement objective is to present the amount paid to acquire an asset, a universal principle to exclude all transaction costs is inconsistent with that measurement objective. Conversely, a principle to include all transaction costs in the amount paid to acquire an asset is inconsistent with the measurement objective of measuring the amount to sell an asset. While option 4 has the benefit of providing a clear, simple accounting treatment, which can be consistently applied to all transaction costs, regardless of the applicable measurement basis and the circumstances of measurement, and preparers will find this approach straightforward to apply, multiple measurement objectives make this a challenging option to pursue.
- 3.39. Similarly, the Board identified challenges in pursuing options 2 or 3. The Board considers the public sector measurement project an opportunity to address measurement of assets and liabilities in one standard. Ignoring transaction costs, option 3, or developing guidance in each IPSAS, option 2, contradicts the Board's stated objective in pursuing the development of Public Sector Measurement.
- 3.40. Option 1 presents the Board with an ambitious goal; to address transaction costs for all IPSAS in one standard. However, developing holistic measurement guidance located in one IPSAS was an objective of the Board in pursuing this project. The development of a universal definition of transaction costs that applies equally to all IPSAS, as noted in paragraph 3.34, is an encouraging step and supports the view that if transaction costs are the same regardless of the nature of the transaction, guidance can be developed in a consistent manner.<sup>5</sup>

### **Preliminary View—Chapter 3.3**

The IPSASB's view is that transaction costs should be addressed in the measurement standard for all IPSAS.

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons, the other option that you support instead, and your reasons for supporting that other option.

### *Accounting for Transaction Costs*

- 3.41. Financial reporting standards may require that transaction costs be capitalized when initially measuring the cost of an asset, and thus reflected in the amount at which an asset is carried in the financial statements. This suggests that they are viewed as adding to the value of an asset's future economic benefits and/or service potential. By contrast, economists and investors view transaction

<sup>5</sup> Consequential amendments associated with developing holistic transaction costs guidance will be addressed in conjunction with the review of constituent feedback on the measurement proposals in this CP, including those illustrated in ED, *Measurement*.

costs as expenses that do not add value<sup>6</sup>. They result from market imperfections and are sometimes called “frictional costs”. A market improves if transaction costs reduce.<sup>7</sup>

3.42. When accounting for transaction costs, IPSAS generally require an entity to capitalize transaction costs for an entry value (see, for example, IPSASs 17 and 31), and deduct transaction costs to derive an exit value (see, for example, IPSAS 27, Agriculture). However, some ambiguity exists. For example:

- (a) IPSAS does not state whether the ‘fair value’ (as currently defined in IPSAS) of an asset acquired through a non-exchange transaction includes an estimate of transaction costs.
- (b) When replacement cost is used, as an appropriate measure for deemed cost or ‘fair value’/current value, IPSAS does not explain whether an estimate of transaction costs should be used to calculate the replacement cost.
- (c) IPSAS does not explain how to account for future estimates of transaction costs necessary to fulfill the obligations, when measuring non-financial liabilities.

3.43. In evaluating the appropriate accounting for transaction costs, the Board considered the requirements developed in IVS and GFS.

IVS	GFS
<p>IVS explain that most bases of value represent the estimated exchange price of an asset without regard to the seller’s costs of sale or the buyer’s costs of purchase and without adjustment for any taxes payable by either party as a direct result of the transaction. (IVS 2017, 210.1)</p> <p>IVS state that the cost approach should capture all of the costs that would be incurred by a typical participant and so transaction costs may be included when valuing assets. (IVS 2017, 70.10)</p>	<p>Transactions costs are called “costs of ownership transfer” in GFS. They are:</p> <ul style="list-style-type: none"> <li>(a) Included in the cost of acquisition for nonfinancial assets; and</li> <li>(b) Expensed for financial assets and liabilities (GFSM 2014 glossary, 8.6)</li> </ul>

3.44. In evaluating how to account for transaction costs, the Board focused on the objective of measurement for financial statement purposes. The objective of measurement is to select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purpose.<sup>8</sup>

<sup>6</sup> Economics definition: “The cost associated with exchange of goods or services and incurred in overcoming market imperfections. Transaction costs cover a wide range: communication charges, legal fees, informational cost of finding the price, quality, and durability, etc., and may also include transportation costs.”

<http://www.businessdictionary.com/definition/transaction-cost.html>

<sup>7</sup> See <http://www.investopedia.com/terms/t/transactioncosts.asp>

<sup>8</sup> Paragraph 7.2 of the Conceptual Framework

3.45. In order to fairly reflect the cost of service, operational capacity or financial capacity and to best enable decision-making, an entity must determine what measurement bases is most relevant to the financial statement user in order to make a decision. Regardless of the measurement bases, a decision-maker requires information that allows them to evaluate the amount required to support the provision of services, or the amount available to fund those services:

(a) Amount required to support the provision of services

The purpose of this amount is to provide users with information about the value of the asset or the liability to the entity. This is an entry price or a price specific to the entity. Transaction costs are relevant in valuation.

For example, an entity acquires a parcel of land for CU100,000 and pays CU5,000 in transfer fees with the sole objective of using the land for production. The transfer fees of CU5,000 are useful information to the user of the financial statements because they indicate the entity is of the view the productive value of the land is equal to or exceeds CU105,000.

(b) Amount available to fund services

This purpose of this amount is to provide users with information about how much the entity would receive to hold the asset and earn a stream of income, to sell the asset or have to pay to extinguish the liability. The price is an exit price or a market price. The costs to enter into the transaction are irrelevant.

For example, an entity acquires a parcel of land and pays CU5,000 in transfer fees. The sole objective of purchasing the land is to sell it in the foreseeable future. The transfer fees of CU5,000 is not useful information to the user of the financial statements. The user wants to know how much the asset can be sold for.

3.46. In applying the concept that transaction costs are included in the measurement of entry prices and excluded from the measurement of exit prices, the following conclusion is reached:

Figure 3.1 – Accounting for Transaction Costs

Measurement Basis	Measurement Objective	Accounting for Transaction Costs
Cost of Fulfillment (Appendix 1 of Exposure Draft)	Exit price	Include (see footnote 9)
Fair Value (Appendix 2 of Exposure Draft)	Exit price	Exclude (expense)
Historical Cost (Appendix 3 of Exposure Draft)	Entry price	Include (capitalize)
Replacement Cost (Appendix 4 of Exposure Draft)	Entry price	Include (capitalize)

<sup>9</sup> The cost of fulfillment is a measure of extinguishing an obligation. As cost of fulfillment is the amount required to exit a transaction, it is an exit price. In order to faithfully represent the costs associated with exiting this obligation, any incremental costs directly related to settling the liability are included so that the user of the information understands the amount required to extinguish the obligation. In contrast, the fair value of a liability represents the amount required to be paid to transfer the liability.

**Preliminary View—Chapter 3.4**

The IPSASB's view is that transaction costs should be:

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

Do you agree with the IPSASB's Preliminary View?

If not, please provide your reasons, the other option that you support instead, and your reasons for supporting that other option.

Appendix A – Equivalence Table

**Table 3.1 - International Public Sector Accounting Standards Board Conceptual Framework: The Measurement Models**

	IPSAS	IVS 2017	GFS 2014
Historical cost model allowed?	Yes	No	No
Revaluation model allowed?	Yes	Yes	Yes

**Table 3.2 - International Public Sector Accounting Standards Board Conceptual Framework: Measurement Bases and Associated Terms and their Equivalents in International Valuation Statistics 2017 and the Government Finance Statistics Manual 2014**

	IPSAS	IVS 2017	GFS 2014	Comment
<b>Fair value</b>	<b>The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (IFRS 13)</b>	<b>Fair Value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.</b>	<b>Fair value is a market-equivalent value defined as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s-length transaction.</b>	The three sources appear to be generally aligned.  There do not appear to be any terms in IVS or GFS that need to be imported into IPSAS.
Active market (IFRS 13)	A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis.	See, for example, IVS 105, para. 10.8 “Although no one approach or method is applicable in all circumstances, price information from an active market is generally considered to be the strongest evidence of value. Some bases of value may prohibit a valuer from making subjective adjustments to price information from an active market. Price information from an inactive market may still be good evidence of value, but subjective adjustments may be needed.”	See, for example, para. 1.29 “While current market prices are readily available for assets and liabilities that are traded in active markets, valuation according to market-value equivalents is used for valuing assets and liabilities that are not traded in markets, or are traded only infrequently.”	
Active market (IPSAS 21)	An active market is a market in which all the following conditions exist: (a) The items traded within the market are homogeneous; (b) Willing buyers and sellers can normally be found at any time; and (c) Prices are available to the public.			
Entry price (IFRS 13)	The price paid to acquire an asset or received to assume a liability in an exchange transaction.	Description of <a href="#">cost approach</a> and <a href="#">market value</a> use similar ideas.	No equivalent.	

IPSAS		IVS 2017	GFS 2014	Comment
Entry value (Conceptual Framework, para 7.8 to 7.9)	An entry value reflects the cost of purchase for assets and, for liabilities, relates to the transaction under which an obligation is received or the amount that an entity would accept to assume a liability.	Description of <a href="#">cost approach</a> and <a href="#">market value</a> use similar ideas.	“In principle, current market prices should be available for most types of inventories, but in practice, the values of inventories frequently are estimated by adjusting book or acquisition values of inventories with the aid of price indexes.” (Paragraph 7.78)	
Exit price (IFRS 13)	The price that would be received to sell an asset or paid to transfer a liability.	Reference to “market approach/exit value” in para. 50.22 IVS 105. Para. 50.24 states that “The market approach/exit value method can be performed in a number of ways, but the ultimate goal is to calculate the value of the asset at the end of the explicit cash flow forecast.”	There are references to “sale price” (e.g. para. 5.88) with respect to assets, but no references to transfer costs or price with respect to liabilities. (Transfer payments related to social benefits has a different meaning.)	
Exit values (Conceptual Framework, para 7.8 to 7.9):	Exit values reflect the economic benefits from sale of an asset and also the amount that will be derived from use of the asset, and, for liabilities, the amount required to fulfil an obligation or the amount required to release the entity from an obligation.	Similar to “market approach/exit value” in IVS 105 para. 50.22.	No equivalent.	
Highest and best use (IFRS 13)	The use of a non-financial asset by market participants that would maximise the value of the asset or the group of assets and liabilities (e.g. a business) within which the asset would be used.	See IVS 104, 140.1-140.5. “Highest and best use is the use, from a participant perspective, that would produce the highest value for an asset. Although the concept is most frequently applied to non-financial assets as many financial assets do not have alternative uses, there may be circumstances where the highest and best use of financial assets needs to be considered.”	No equivalent.	
Income approach (IFRS 13)	Valuation techniques that convert future amounts (e.g. cash flows or income and expenses) to a	IVS 105, 40.1: The income approach provides an indication of	The “present value of future returns” are defined as: “In some	

	IPSAS	IVS 2017	GFS 2014	Comment
	single current (i.e. discounted) amount. The fair value measurement is determined on the basis of the value indicated by current market expectations about those future amounts.	value by converting future cash flow to a single current value. Under the income approach, the value of an asset is determined by reference to the value of income, cash flow or cost savings generated by the asset. <i>income approach methods</i> (IVS 2017, IVS 105, 50.1.) Income approach methods are ways to implement the income approach, and are [all] effectively based on discounting future amounts of cash flow to present value. They are variations of the Discounted Cash Flow (DCF) method.	cases, current market prices may be approximated by the present value of the future economic benefits expected from a given asset. Current prices can also be approximated by net present value when there are costs of bringing assets to the market. The economic benefit and costs can be discounted to estimate the net present value of the asset. (Paragraph 7.33)	
Inputs (IFRS 13)	The assumptions that market participants would use when pricing the asset or liability, including assumptions about risk, such as the following: (a) the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model); and (b) the risk inherent in the inputs to the valuation technique. Inputs may be observable or unobservable.	See, for example, IVS 300 para. 20.3, where the reference to “assumptions” appears to have a similar meaning to that of “inputs.”	No equivalent.	
<i>Level 1 inputs</i>	Quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.	See, for example, IVS 105, para. 10.8 for reference to <a href="#">active markets</a> .	No equivalent.	
<i>Level 2 inputs</i>	Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.	No equivalent.	No equivalent.	
<i>Level 3 inputs</i>	Unobservable inputs for the asset or liability.	No equivalent.	No equivalent.	
<i>Market-corroborated inputs</i>	Inputs that are derived principally from or corroborated by observable market data by correlation or other means.	See, for example, IVS 105, para. 10.8 for reference to <a href="#">active markets</a> .	No equivalent.	
<i>Observable inputs</i>	Inputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the		The idea of observable market prices is in para. 7.24, which states that “Ideally, observable market	

	IPSAS	IVS 2017	GFS 2014	Comment
	assumptions that market participants would use when pricing the asset or liability.		prices should be used to value all assets and liabilities in a balance sheet. However, in estimating the current market price for balance sheet valuation, a price averaged over all transactions in a market can be used if the market is one on which the items in question are regularly, actively, and freely traded.	
Market approach (IFRS 13)	A valuation technique that uses prices and other relevant information generated by market transactions involving identical or comparable (i.e. similar) assets, liabilities or a group of assets and liabilities, such as a business.	See IVS 105, 20.1. The market approach provides an indication of value by comparing the asset with identical or comparable (that is similar) assets for which price information is available.	“Stock positions should be valued at market value—that is, as if they were acquired in market transactions on the balance sheet reporting date (reference date). Market prices are readily available for assets and liabilities that are traded in active markets, most commonly certain financial assets and their corresponding liabilities. (Paragraph 3.113)	
Market participant (IFRS 13)	Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics: (a) They are independent of each other, i.e. they are not related parties as defined in IAS 24, although the price in a related party transaction may be used as an input to a fair value measurement if the entity has evidence that the transaction was entered into at market terms. (b) They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary. (c) They are able to enter into a transaction for the asset or liability. (d) They are willing to enter into a transaction for the asset or liability, i.e. they are motivated but not forced or otherwise compelled to do so.	There are references to market participants in several IVS (see, for example, IVS 104, 30.5 and elsewhere in IVS 104.	No equivalence, although there are references to buyers and sellers (see for example para. 7.156).	

IPSAS		IVS 2017	GFS 2014	Comment	
	<i>Most advantageous market</i>	The market that maximises the amount that would be received to sell the asset or minimises the amount that would be paid to transfer the liability, after taking into account transaction costs and transport costs.	No equivalent.	No equivalent.	
	Orderly transaction (IFRS 13)	A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (e.g. a forced liquidation or distress sale).	See IVS 104, 160.1: an orderly liquidation describes the value of a group of assets that could be realised in a liquidation sale, given a reasonable period of time to find a purchaser (or purchasers), with the seller being compelled to sell on an as-is, where-is basis.	No equivalent.	
	Principal market (IFRS 13)	The market with the greatest volume and level of activity for the asset or liability.	No equivalent.	Reference to the idea of relevant market “Generally, market prices should be taken from the markets where the same or similar items are currently traded in sufficient numbers and in similar circumstances.” (Paragraph 3.111)	
<b>Market value</b>	<b>Market value for assets is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction. Market value for liabilities is the amount for which a liability could be settled between knowledgeable, willing parties in an arm’s length transaction. (CF, para 7.24 and 7.80)</b>	<b>IVS 104, 30.1: “Market Value is the estimated amount for which an asset or liability should exchange on the valuation date between a willing buyer and a willing seller in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion”</b>	<b>Market prices refer to current exchange value—that is, the value at which goods, services, labor, or assets are exchanged or else could be exchanged for cash (currency or transferable deposits). (Paragraph 3.107)</b>	The three sources appear to be aligned. However, the definitions are very close to the definition of fair value and the terms associated with fair value could be seen as being equally relevant to market value.	
<b>Replacement cost</b>	<b>Replacement cost is the optimized depreciated replacement cost of an asset (CF, 7.40, 7.47 and footnote 14).</b>	<b>Generally, replacement cost is the cost that is relevant to determining the price that a participant would pay as it is based on replicating the utility</b>	<b>Written-down replacement cost is the current acquisition price of an equivalent new asset minus the accumulated consumption of</b>	The definitions of replacement cost (or optimized depreciated replacement cost)	

IPSAS		IVS 2017	GFS 2014	Comment
		<b>of the asset, not the exact physical properties of the asset. (IVS 105, 70.2)</b>	<b>fixed capital, amortization, or depletion. (para 3.115)</b>	and written-down replacement cost appear to align.
Cost approach (IFRS 13)	A valuation technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as current replacement cost).	See IVS 105, 60.1. The cost approach provides an indication of value using the economic principle that a buyer will pay no more for an asset than the cost to obtain an asset of equal utility, whether by purchase or by construction, unless undue time, inconvenience, risk or other factors are involved. The approach provides an indication of value by calculating the current replacement or reproduction cost of an asset and making deductions for physical deterioration and all other relevant forms of obsolescence. See also cost approach method (IVS 2017, IVS 105, 70.1)	“Written-down replacement cost” is “the current acquisition price of an equivalent new asset minus the accumulated consumption of fixed capital, amortization, or depletion.”	
Current replacement cost (IPSAS 12)	The cost the entity would incur to acquire the asset on the reporting date.			
<b>Net selling price</b>	<b>The amount that the entity can obtain from sale of the asset, after deducting the costs of sale. (CF, para 7.49)</b>	See <a href="#">Liquidation Value</a> below	<b>No equivalent.</b>	IVS measurement basis ‘Liquidation Value’ appears to equate to IPSAS ‘Net Selling Price’.  Need to consider further during Phase 2 of the Measurement Project, including the link with fair value.
Costs of disposal (IPSAS 21)	The incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.	Reference to “transaction costs” in para 210.1 includes the phrase: “...the seller’s costs of sale...”	See, for example, para 6.60: “Cost of ownership transfer on the disposal of an asset”.	
Costs to sell (IPSAS 27)	Costs to sell are the incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes. Disposal may occur through sale or through distribution at no charge or for a nominal charge.			
Fair value less costs to sell (IPSAS 21)	The amount obtainable from the sale of an asset in an arm’s length transaction between knowledgeable, willing parties, less the costs of disposal.	See <a href="#">Liquidation Value</a> below.	No equivalent.	

IPSAS		IVS 2017	GFS 2014	Comment
Net realizable value (IPSAS 12)	The estimated selling price in the ordinary course of operations, less the estimated costs of completion and the estimated costs necessary to make the sale, exchange or distribution.	No equivalent.	No equivalent.	
Recoverable amount (IPSAS 17)	The higher of a cash-generating asset's fair value less costs to sell and its value in use.	No equivalent.	No equivalent.	
Recoverable amount (of an asset or a cash-generating unit) (IPSAS 26)	The higher of an asset's or a cash-generating unit's fair value less costs to sell and its value in use.	No equivalent.	No equivalent.	
Recoverable service amount (IPSAS 21)	The higher of a non-cash-generating asset's fair value less costs to sell and its value in use.	No equivalent.	No equivalent.	
<b>Value in Use</b>	<b>The present value to the entity of the asset's remaining service potential or ability to generate 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. (CF, para 7.58)</b>	See <a href="#">Investment Value</a> .	<b>No equivalent.</b>	IVS measurement basis 'Investment Value' appears to equate to IPSAS 'Value in Use'.  Need to consider during Phase 2 of the Measurement Project.
Entity-specific value (IPSAS 17)	An entity-specific value is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.	See definition of 'entity-specific factors' in IVS 104 and 180.1-180.3.	No equivalent.	
Value in use of a cash-generating asset (IPSAS 26)	Flows expected to be derived from the continuing use of an asset and from its disposal at the end of its useful life	No equivalent.	"Assets can be valued at the discounted present value of their expected future returns." (Paragraph 3.125)	
Value in use of a non-cash-	The present value of the asset's remaining service potential.	No equivalent.	No equivalent.	

IPSAS		IVS 2017	GFS 2014	Comment
generating asset (IPSAS 21)				
Service potential (Conceptual Framework, para 5.8-5.9):	Service potential is the capacity to provide services that contribute to achieving the entity’s objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows.	IVS 300, para. 20.5, refers to functional potential, which may have a similar meaning. (“A valuation of plant and equipment will normally require consideration of a range of factors relating to the asset itself, its environment and physical, functional and economic potential.”)	No equivalent.	

**Table 3.3 - International Valuation Standards 2017: Measurement Bases and their Equivalents in International Public Sector Accounting Standards and the Government Finance Statistics Manual 2014**

IPSAS	IVS 2017	GFS 2014	Comment	
<b>Market Rent</b>	<b>No equivalent in IPSAS.</b>	<b>The estimated amount for which an interest in real property should be leased on the valuation date between a willing lessor and a willing lessee on appropriate lease terms in an arm’s length transaction, after proper marketing and where the parties had each acted knowledgeably, prudently and without compulsion.</b>	<b>No equivalent in GFS.</b>	The IVS ‘Market Rent’ basis is specific to Leases and could usefully be considered by the Leases Project.
<b>Equitable Value</b>	<b>No equivalent in IPSAS.</b>	<b>The estimated price for the transfer of an asset or liability between identified knowledgeable and willing parties that reflects the respective interests of those parties.</b>	<b>No equivalent in GFS.</b>	This may be relevant for some public sector transactions and should be considered further in Phase 2 of the Measurement Project.

	IPSAS	IVS 2017	GFS 2014	Comment
Investment Value	See IPSAS definition of Value in Use	The value of an asset to a particular owner or prospective owner for individual investment or operational objectives.	No equivalent in GFS.	See comments against IPSAS basis ' <a href="#">Value in Use</a> '.
Synergistic Value	No equivalent in IPSAS.	The result of a combination of two or more assets or interests where the combined value is more than the sum of the separate values.	No equivalent in GFS.	This may be relevant for some public sector transactions and should be considered further in Phase 2 of the Measurement Project.
Liquidation Value	See IPSAS definition of Net Selling Price	The amount that would be realised when an asset or group of assets are sold on a piecemeal basis. Liquidation Value should take into account the costs of getting the assets into saleable condition as well as those of the disposal activity.	No equivalent in GFS.	See comments against IPSAS basis 'Net Selling Price'.