

Meeting: International Public Sector Accounting Standards Board

Meeting Location: Virtual Meeting

Meeting Date: June 23–26, 2020

Agenda Item 7

For:

Approval

Discussion

Information

MEASUREMENT

Project summary	Project will revise IPSAS requirements for measurement, provide guidance on measurement and address the treatment of transaction costs and borrowing costs.	
Meeting objectives	Topic	Agenda Item
Project management	Measurement: Project Roadmap	7.1.1
	Instructions up to Previous Meeting	7.1.2
	Decisions up to Previous Meeting	7.1.3
Decisions required at this meeting	Overview of Q2 2020 CF-LSU and Measurement Issues	7.2.1
	Measurement Guidance: Placement	7.2.2
	Applying IFRS 13 Fair Value Throughout IPSAS	7.2.3
	Fair Value – Improvements to Measurement Bases Guidance	7.2.4
	Fulfillment Value – Improvements to Measurement Bases Guidance	7.2.5
	Historical Cost – Improvements to Measurement Bases Guidance	7.2.6
	Replacement Cost – Improvements to Measurement Bases Guidance	7.2.7
	Amendments to IPSAS 5, Borrowing Costs	7.2.8
Other supporting items	Measurement Methodology Flow Charts	7.3.1
	Fair Value (Unedited Responses)	7.3.2
	Fulfillment Value (Unedited Responses)	7.3.3
	Historical Cost (Unedited Responses)	7.3.4
	Replacement Cost (Unedited Responses)	7.3.5
	[draft] ED X, Improvements to IPSAS 5, Borrowing Costs	7.3.6

**MEASUREMENT:
PROJECT ROADMAP**

Meeting	Completed Actions or Discussions / Planned Actions or Discussions:
March 2019	1. Approve Consultation Paper and Illustrative Exposure Draft
June 2019	1. Document out for comment
September 2019	1. Document out for comment
December 2019	1. Preliminary Review of Responses to Consultation Paper
March 2020	1. Review of Responses to Consultation Paper 1. Discussion of Issues
June 2020	1. Discussion of Issues
September 2020	1. Discussion of Issues 2. Discuss proposed consequential amendments 3. Review [draft] Exposure Draft
December 2020	1. Approve Exposure Draft

INSTRUCTIONS UP TO PREVIOUS MEETING

Meeting	Instruction	Actioned
March 2020	1. Action the PVs and SMCs based on the recommendations proposed.	<p>1. Actioned in Q2 2020</p> <ul style="list-style-type: none"> - Theme A – See Agenda Item 7.2.8 - Theme B – See Agenda Item 6.2.7 and Agenda Item 7.2.2 - Theme C – See Agenda Item 6.2.3, 6.2.4 and 6.2.5 - Theme D – See Agenda Item 7.2.3 - Theme F – See Agenda Item 7.2.4 – 7.2.7 <p>In progress (Q3 2020)</p> <ul style="list-style-type: none"> - Theme E – Fulfillment Value - Theme G – Flowcharts - Theme H – Exposure Draft
	2. Distinguish between borrowing costs and transaction costs in the BCs of IPSAS 5.	2. See Agenda Item 7.3.6 (paragraph BC 8 – BC 11)
	3. Develop IEs and/or IGs to replace AGs proposed clarifying “qualifying asset” and “directly attributable”.	3. See Agenda Item 7.3.6
	4. Develop a paper on Historical Cost to consider impact of guidance centralisation indicating: <ul style="list-style-type: none"> - The source of the AGs; - Where the historical cost guidance is applicable; and - Differences to current guidance, and whether these would need to be retained. 	4. To be developed for September 2020 meeting to supplement the analysis of the Historical Cost Application Guidance
December 2019	1. Prepare a detailed review of responses for the March 2020 meeting.	1. See Agenda Item 8.3.1 – Agenda Item 8.3.15 .
	2. Provide recommendations on how to take accounting for borrowing costs forward, based largely on the retention of the current approach (including draft text).	2. Retain Accounting Policy Choice to expense / capitalize borrowing costs. BCs of IPSAS 5 are updated to reflect decision (See Agenda Item 8.2.3)
March 2019	1. All instructions provided up until March 2019 were reflected in the Consultation Paper on Measurement .	1. All instructions provided up until March 2019 were reflected in the Consultation Paper on Measurement .

DECISIONS UP TO PREVIOUS MEETING

Meeting	Decision	BC Reference
March 2020	1. No decisions made (detailed review of responses)	1. Not applicable
December 2019	1. No decisions made (preliminary review of responses)	1. Not applicable
March 2019	2. All decisions made up until March 2019 were reflected in the Consultation Paper on Measurement .	2. All decisions made up until March 2019 were reflected in the Consultation Paper on Measurement .

Overview of Q2 2020 CF-LSU and Measurement Issues

Purpose

1. To summarize the issues addressed during Q2 2020 across the Conceptual Framework – Limited-Scope Update and Measurement projects.

Background

2. In March 2020 the Board agreed to implement a coordinated approach to develop EDs for:
 - (a) Measurement;
 - (b) Property, Plant and Equipment (Updated IPSAS 17); and
 - (c) Conceptual Framework – Limited-Scope Update
3. The Board instructed staff to coordinate the development of the related EDs and manage cross-cutting issues.

Analysis

4. The following table summarizes where issues addressed in Q2 2020 related to the CF-LSU and Measurement projects are in the suite of agenda papers.

Issues Paper	Theme of Paper	Agenda Paper
Approval of Measurement Hierarchy Staff presenter – John Stanford	Model	Agenda Item 6.2.2
Fair Value & Market Value – Should Market Value be a Measurement Basis? Staff presenter – John Stanford	Bases	Agenda Item 6.2.3
What are the Measurement Bases to be Defined in the Conceptual Framework? Staff presenter – John Stanford		Agenda Item 6.2.4
Replacement Cost as a Measurement Basis or a Measurement Technique Staff presenter – Dave Warren		Agenda Item 6.2.5
Value in Use as a Measurement Basis or Measurement Technique Staff presenter – John Stanford		Agenda Item 6.2.6
Synergistic and Equitable Value Staff presenter – Dave Warren		Agenda Item 6.2.7
The Usefulness of the Distinction Between Entry and Exit Values Staff presenter – John Stanford		Agenda Item 6.2.8
Measurement Guidance: Placement Staff presenter – Dave Warren		Location of guidance

Agenda Item 7.2.1

Issues Paper	Theme of Paper	Agenda Paper
Applying IFRS 13 FV Throughout IPSAS Staff presenter – Eileen Zhou	Application of Measurement Principles	Agenda Item 7.2.3
Analysis of Responses (Improvements to Measurement Bases Guidance) Staff presenter – Dave Warren		Agenda Item 7.2.4 – 7.2.7
Amendments to IPSAS 5, <i>Borrowing Costs</i> Staff presenter – Dave Warren		Agenda Item 7.2.8

5. Many of the agenda items have been reviewed by the Measurement Task Force. When this occurred, the recommendation was elevated from staff recommendation to task force recommendation. Agenda Items without a Task Force recommendation were not reviewed by the Task Force due to the number of issues addressed. Staff selected Agenda Items for Task Force review based on the complexity of the issue, IPSASB instruction and when the issue was addressed.

Measurement Guidance: Placement

Question

1. Does the IPSASB agree with the location of the measurement guidance set out in the agenda item?

Recommendation

2. Staff recommend the location of measurement guidance be set as follows:
 - (a) **Conceptual Framework.** Provides guidance on measurement models and measurement bases.
 - (b) **ED 75, Measurement.** Provides guidance on measurement bases and how to calculate them (i.e., measurement techniques).
 - (i) **Core Text.** Identify and define the measurement bases (aligned with the conceptual framework).
 - (ii) **Application Guidance.** One AG will be developed for each measurement basis identified in the core text. AG will provide guidance on how to calculate the basis in practice (i.e., measurement technique).
 - (c) **IPSAS Suite of Standards.** Guidance is provided at the measurement basis level.

Background

3. In Agenda Item 6.2.2, the Conceptual Framework – Limited Scope Update (CF-LSU) project introduces a measurement hierarchy. Within this hierarchy exists:
 - (a) **Measurement Models** are the approaches to the presentation of assets or liabilities;
 - (b) **Measurement bases** provide the most relevant and faithfully representative information under the model selected; and
 - (c) **Measurement techniques** are methods to estimate the amount at which an asset or liability is presented under selected measurement basis.
4. As part of the CF-LSU, the following measurement bases were identified (see Agenda Item 6.2.3 for details on how these bases were identified).
 - (a) Historical Cost;
 - (b) Fair Value;
 - (c) Fulfillment Value; and
 - (d) Current Cost.
5. Each measurement basis includes at least one technique that can be applied for estimating amounts under the selected measurement basis.

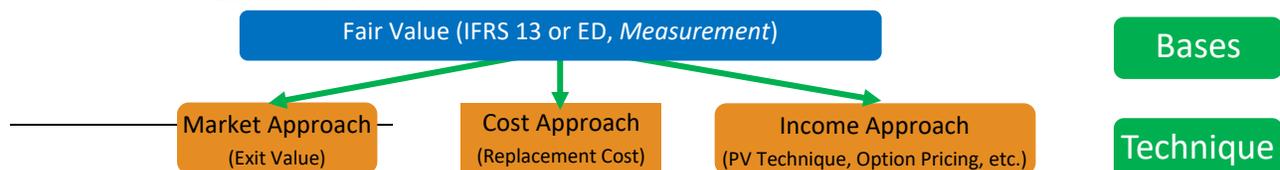
Analysis

Conceptual Framework

6. The concepts in the Framework underpin the development of IPSAS. A strong Framework provides concepts that are applied consistently at standards level. Guidance in the Framework must be applicable across a broad set of IPSAS.
7. Measurement models are broad concepts that provide users with important information depending on their needs.
8. Measurement bases are also broad concepts as they provide users with different information, within the context of a historical cost or current value model. For example, both fair value and current cost are bases within the current value model. Both are updated based on current market conditions at the measurement date, but fair value reflects the amount an entity receives to exit a transaction, while current cost reflects the amount an equivalent item could be acquired for at the measurement date.

ED 75, Measurement

9. One objective of the measurement project is to provide detailed guidance on the implementation of commonly used measurement bases, and the circumstances under which these measurement bases will be used.
10. In order to satisfy this objective, CP, *Measurement*, proposed AGs be developed for each commonly used measurement basis.¹ Those measurement bases identified are largely consistent with the measurement bases proposed in the CF-LSU.² As such, maintaining the AGs at the measurement bases level is consistent with one of the overall objectives of the project.
11. As measurement techniques are applied in estimating a measurement basis, complete information on each measurement basis requires guidance for measurement techniques be included in the AG for the basis to which they apply.
12. Including measurement bases and techniques in ED 75, *Measurement* is:
 - (a) **Consistent with approach followed in CP, *Measurement*.** As noted in paragraph 7, measurement bases developed as AGs in the CP are largely consistent with the measurement bases proposed in the CF-LSU. Maintaining consistency with the AGs developed aligns with the views of respondents who were supportive of the measurement bases identified as AGs.
 - (b) **Consistent with IFRS 13.** This approach is consistent with the structure of IFRS 13 and applied in the Fair Value AG. The Fair Value AG explains the basis and techniques available to estimate Fair Value.



¹ CP, *Measurement*, identified four measurement bases for which AGs were developed (Fair Value, Fulfillment Value, Historical Cost and Replacement Cost). Value in Use was identified as a measurement basis in the CP, but no AGs were developed as it was concluded it was specific to IAS 21 and IAS 26. Replacement Cost is proposed to be a measurement technique in the CF-LSU.

² Staff conclude the concept "measurement bases" is consistent between CP, *Measurement*, and the CF-LSU.

IPSAS Suite of Standards

13. Standards provide guidance on how to account for items given the needs of the users of the financial statements. This is consistent with the concept of a measurement basis. Measurement bases provide relevant information under the model selected. Measurement bases consider the information needs of users, while techniques consider the information available to estimate an amount under a selected measurement basis.
14. Providing guidance in the IPSAS Suite of Standards at a measurement bases level is:
 - (a) **Consistent with current IPSAS.** Most IPSAS prescribe one or more measurement bases when measuring assets or liabilities (see [Appendix B](#)). Measurement techniques are selected by the financial statement preparer based on the information available and the facts and circumstances of the transaction. For example, IPSAS 41, prescribes fair value when measuring some financial instruments. Depending on whether market data is available impacts the technique applied to estimate fair value.

Decision Required

15. Does the IPSASB agree with Staff's recommendation

Appendix A – Draft Table of Contents for ED 75

Purpose

1. To provide the Board with an overview of ED 75, *Measurement* given the recommendations in [Agenda Item 7.2.2](#).
2. Changes are tracked from illustrative exposure draft included as an appendix to CP, *Measurement*.

EXPOSURE DRAFT XX, MEASUREMENT

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Placeholder (potential measurement basis identified in Q3 2020)	XX
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Basis for Conclusions	BC1

Appendix B – Measurement Prescribed in IPSAS

Measurement Bases (current conceptual framework)	Standard where applied	Notes
Fair Value	IPSAS 16, 17 and 41	AG exists
Fulfillment Value	IPSAS 19	AG exists
Historical cost	IPSAS 16, IPSAS 17	AG exists
Replacement cost	IPSAS 17, IPSAS 33	No action necessary – Paragraph 47 of IPSAS 17 states that depreciated replacement cost is an estimation technique.
Net realizable value	IPSAS 12	One-time use
Value in use	IPSAS 21 and 26	See agenda item 6.2.6.
Market value	Not Applied	-
Cost of release	Not Applied	-
Assumption price	Not Applied	-

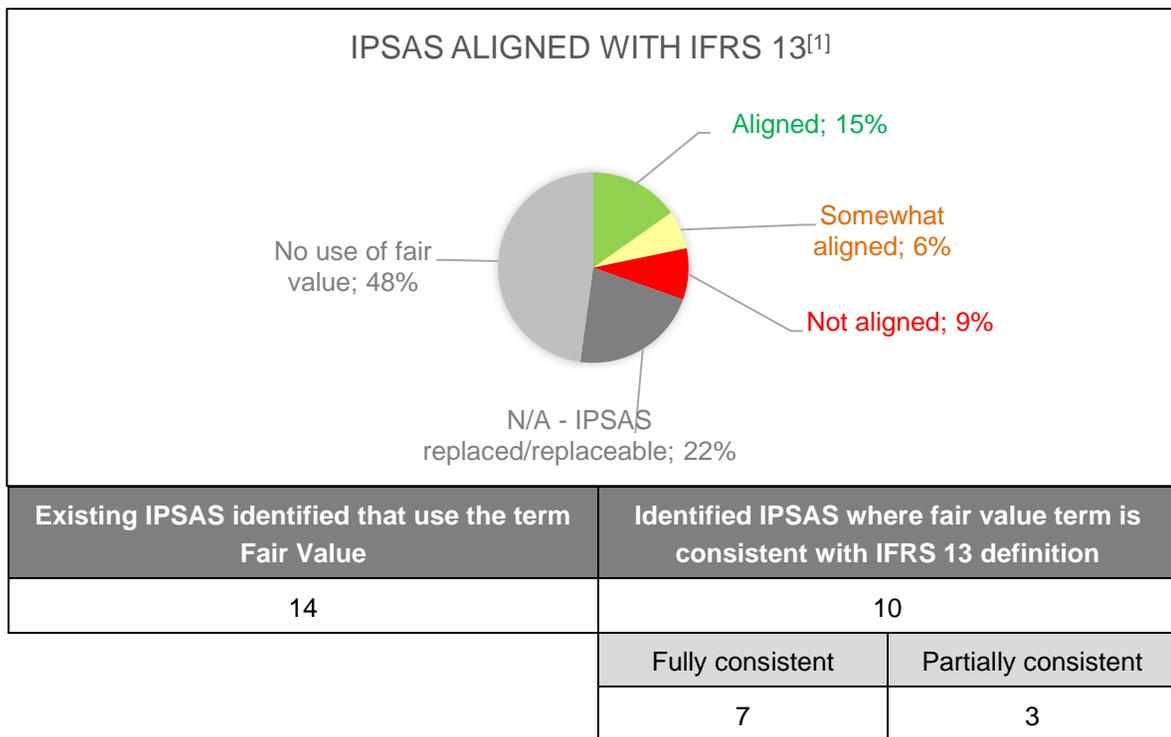
Applying IFRS 13 Fair Value Throughout IPSAS

Question

1. Does the IPSASB agree with the assessment of whether the term fair value used in IPSAS aligns with the definition in IFRS 13 and CP, *Measurement*?

Recommendation

2. The term fair value, as defined in IFRS 13 and in CP, *Measurement*, is applied in ten IPSAS in the 2020 Handbook. The Task Force recommends:
 - (a) The term fair value should be maintained in seven of these IPSAS.
 - (b) The term fair value should be partially maintained in three of these IPSAS (see discussion on IPSAS 33, 35 and 36 in the table below).
3. The use of the term fair value in four other IPSAS appear to be inconsistent with the definition in IFRS 13 and CP, *Measurement*. Staff will develop recommendations on an appropriate measurement basis for the September 2020 IPSASB meeting.



^[1] Staff reviewed all IPSAS in the 2020 Handbook. 19 IPSAS did not refer to fair value or did not use the term fair value in the context of measurement guidance and defer to other IPSAS. 13 other IPSAS are analyzed in other active projects, or have been or will be superseded. See Analysis section.

Background

6. The fair value definition³ put forward in CP, *Measurement* is consistent with IASB's definition of fair value in IFRS 13. However, this definition differs from what is currently applied across IPSAS⁴. Respondents to the CP proposed a review of existing IPSAS to determine whether fair value as currently applied in IPSAS is conceptually consistent with the new definition of fair value (stated in IFRS 13 and proposed in the CP (March 2020 Agenda Item 8.2.5)).

Analysis

7. This paper summarizes Staff analysis on whether the current use of the term fair value in IPSAS aligns with the definition in IFRS 13 and CP, *Measurement*. This paper does not indicate how to apply fair value, nor the appropriate measurement basis in lieu of fair value.
8. Staff reviewed each IPSAS in the 2020 Handbook. Specifically, Staff:
 - (a) Identified IPSAS where the existing guidance uses the term fair value; and
 - (b) Analyzed whether continued application of the term fair value is consistent with the definition proposed in the CP.
9. Staff considered the evaluation criteria proposed in the CP, *Measurement*, Measurement Methodology Flowcharts ([Supplemental Documents 1](#)) to determine whether it is still appropriate to apply fair value in a specific IPSAS.
10. The Methodology Flowcharts indicate that fair value is an appropriate measurement basis when the asset is held or the liability incurred for its financial capacity. As such, staff considered why the entity is holding the item in determining whether the item should be measured at its fair value.

Why is the entity holding the item?

- (i) **Financial capacity** – The entity intends to hold the asset or liability to sell, or to use to generate financial return (i.e. for cash flows).
- (ii) **Operational capacity** – The entity intends to hold the asset or liability to provide services.

Holding an item for its financial capacity is an indicator of fair value, as proposed in CP, *Measurement*. Any item held for its financial capacity should be measured at fair value in the applicable IPSAS because fair value measures the value of an asset or liability at its exit value, which is consistent useful information when an asset or liability is held for sale or transfer. Holding an item for its financial capacity implies an item's highest and best use. because Fair Value shows the price to exit a transaction.

³ IFRS 13.9 defines fair value 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.” IFRS 13 also clarified that fair value is the exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability.

⁴ IPSAS 2020 Handbook Volume 3 defines fair value in its Glossary of Defined Terms as “the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arms’ length transaction.” This definition was created, and the references to fair value in the IPSAS was made, prior to the introduction of IFRS 13, and is not explicitly exit-based or entry-based.

11. For IPSAS that currently make reference to fair value, the following table summarizes whether fair value as defined in the CP is applicable.

(a) In some instances, the use of the term fair value is only for a specific section within an IPSAS. For example, inventories encompass numerous subsets:

- (i) Goods purchased and held for resale;
- (ii) Finished goods produced
- (iii) Work-in-progress, materials and supplies; and
- (iv) Harvested agricultural products.

Inventories may also arise from exchange or non-exchange transactions, or be held for distribution or to be consumed to produce goods for distribution at no or nominal cost. However, fair value is only used for non-exchange transactions and harvested agriculture produce from biological assets. Subsets are indicated where necessary in the table below.

(b) Staff's conclusion on whether it is still appropriate to use fair value for consistency with IFRS 13 and CP, *Measurement* is color-coded as follows:

Color	Conclusion
Green	Appropriate
Yellow	Appropriate in certain situations
Orange	Not appropriate

(c) Staff noted that entity- or transaction-specific factors can impact the conclusion on whether the term fair value is appropriate. Upon application, an entity must consider these additional factors and professional judgment when determining whether the item is held for financial or operational capacity. (i.e. IPSAS 35 and IPSAS 36).

(d) See Appendix A for the CP, *Measurement*, "Measurement Methodology" flowcharts considered in this analysis.

IPSAS	Subtopic using Fair Value	Primary measurement objective	Is fair value appropriate for the subtopic?
IPSAS 1, <i>Presentation of Financial Statements</i>	Not assessed – fair value is not used in context of measurement guidance specific to this IPSAS		
IPSAS 2, <i>Cash Flow Statements</i>	Not assessed – fair value is not used in context of measurement guidance specific to this IPSAS		
IPSAS 3, <i>Accounting Policies, Changes in Accounting Estimates and Errors</i>	Not assessed – fair value is not used in context of measurement guidance specific to this IPSAS		
IPSAS 4, <i>The Effects of Changes in Foreign Exchange Rates</i>	Not assessed – fair value is not used in context of measurement guidance specific to this IPSAS		
IPSAS 5, <i>Borrowing Costs</i>	Not assessed – term fair value is not used in core text		
IPSAS 6, <i>Consolidated and Separate Financial Statements</i>	Not assessed – Replaced by IPSAS 34 and IPSAS 35		
IPSAS 7, <i>Investments in Associates</i>	Not assessed – Replaced by IPSAS 37		
IPSAS 8, <i>Interests in Joint Ventures</i>	Not assessed – Replaced by IPSAS 37		
IPSAS 9, <i>Revenue from Exchange Transactions</i>	Not assessed – Consider as part of ED70		
IPSAS 10, <i>Financial Reporting in Hyperinflationary Economies</i>	Not assessed – fair value is not used in context of measurement guidance specific to this IPSAS		

IPSAS	Subtopic using Fair Value	Primary measurement objective	Is fair value appropriate for the subtopic?
IPSAS 11, <i>Construction Contracts</i>	Not assessed – Consider as part of ED70		
IPSAS 12, <i>Inventories</i>	Non-exchange transactions	Financial – inventories are held for sale to generate cash flows, or for consumption in production subsequently sold for financial return	Yes
	Agriculture produce harvested (initial measurement upon harvest)	Financial – inventories are held for sale to generate cash flows, or for consumption in production subsequently sold for financial return	Yes
IPSAS 13, <i>Leases</i>	Not assessed – Consider as part of ED62		
IPSAS 14, <i>Events After the Reporting Date</i>	Not assessed – term fair value is not used in core text		
IPSAS 15	Removed formally from 2020 Handbook		
IPSAS 16, <i>Investment Property</i>	Investment properties acquired through non-exchange transaction, non-monetary exchange, or as result of lease	Financial – by definition, the property is held to earn rentals or for capital appreciation (or both), and not for use in production/supply of goods or services, administrative purposes, or sale in ordinary course of operations	Yes
IPSAS 17, <i>Property, Plant, and Equipment</i>	Not assessed – covered under ED76 / Infrastructure / Heritage projects		
IPSAS 18, <i>Segment Reporting</i>	Not assessed – term fair value is not used in core text		
IPSAS 19, <i>Provisions, Contingent Liabilities and Contingent Assets</i>	Not assessed – term fair value is not used in core text		
IPSAS 20, <i>Related Party Disclosures</i>	Not assessed – fair value is not used in context of measurement guidance specific to this IPSAS		
IPSAS 21, <i>Impairment of Non-Cash-Generating Assets</i>	All	Operational – non-cash generating units are generally held to provide services	No

IPSAS	Subtopic using Fair Value	Primary measurement objective	Is fair value appropriate for the subtopic?
IPSAS 22, <i>Disclosure of Financial Information about the General Government Sector</i>	Not assessed – term fair value is not used in core text		
IPSAS 23, <i>Revenue from Non-Exchange Transactions (Taxes and Transfers)</i>	To be superseded by ED71		
IPSAS 24, <i>Presentation of Budget Information in Financial Statements</i>	Not assessed – term fair value is not used in core text		
IPSAS 25, <i>Employee Benefits</i>	Replaced by IPSAS 39		
IPSAS 26, <i>Impairment of Cash-Generating Assets</i>	All	Financial – cash-generating units by nature are generally held to generate financial return	Yes
IPSAS 27, <i>Agriculture</i>	Biological assets, (including when acquired through non-exchange transaction)	Financial – biological assets generally held to generate financial return rather than to provide services	Yes
	Agricultural produce at point of harvest ⁵	Financial – agricultural produce at point of harvest are generally to generate financial return as inventory assets	Yes
IPSAS 28, <i>Financial Instruments: Presentation</i>	Not assessed – term fair value is not used in core text		
IPSAS 29, <i>Financial Instruments: Recognition and Measurement</i>	Not assessed – fair value is not used in context of measurement guidance specific to this IPSAS		

⁵ Harvested agriculture produce (i.e. subsequent to harvest) becomes IPSAS 12 *Inventories*, or another applicable Standard

IPSAS	Subtopic using Fair Value	Primary measurement objective	Is fair value appropriate for the subtopic?
IPSAS 30, <i>Financial Instruments: Disclosures</i>	Not assessed – fair value is not used in context of measurement guidance specific to this IPSAS		
IPSAS 31, <i>Intangible Assets</i>	Intangible assets acquired through non-exchange transactions, non-monetary exchange, or as part of acquisition	Operational – intangible assets generally are used to provide services	No
IPSAS 32, <i>Service Concession Arrangements: Grantor</i>	Service concession asset provided by operator, or upgrades to existing assets provided by grantor) and related liability (excluding existing assets of grantor ⁶)	Operational – like PP&E, many service concession assets are used to provide public services	No
IPSAS 33, <i>First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)</i>	Deemed cost exemption for specific assets and liabilities (where acquisition cost not available), or assets acquired through non-exchange transaction	Mixed – Assets and liabilities eligible for deemed cost election could be for either operational or financial capacity	Mixed – defer to IPSAS most relevant to in-scope asset/liability
IPSAS 34, <i>Separate Financial Statements</i>	When entity ceases to be an investment entity	Financial – controlled investments are held to generate financial return immediately prior to the change in status from investment entity to non-investment entity. As such fair value is the most relevant information to reflect these controlled investments in consolidated financial statements moving forward.	Yes
	When entity becomes an investment entity	Financial – by purpose and design, an investment entity has purpose of investing solely for returns from capital appreciation, and/or investment revenue	Yes

⁶ Existing assets of the grantor than meet definition of service concession asset are to be reclassified and accounted for per IPSAS 17 or IPSAS 31.

IPSAS	Subtopic using Fair Value	Primary measurement objective	Is fair value appropriate for the subtopic?
IPSAS 35, <i>Consolidated Financial Statements</i>	Change in proportion held by non-controlling interest [non-investment entity]	Financial – change in NCI in a controlled entity reflects an entity’s intent to sell part of its share to the NCI for financial return or increase its share for greater financial return OR Operational – change in NCI in a controlled entity may reflect an entity’s intent to change its share for the purpose of service provision or strategic initiatives	Mixed
	Loss of control [non-investment entity]	Financial – investments no longer controlled by an entity are inherently held to generate financial return	Yes
IPSAS 36, <i>Investments in Associates and Joint Ventures</i>	Interest in an associate or joint venture that is an investment entity	Financial – investments in associates and joint ventures are inherently held to generate financial return	Yes
	Indicator of impairment of equity instrument of the associate or joint venture	Financial – investments in associates and joint ventures are held to generate financial return OR Operational – Investments in associates and joint ventures may be held for strategic initiatives	Mixed
IPSAS 37, <i>Joint Arrangements</i>	Not assessed – fair value is not used in context of measurement guidance specific to this IPSAS		
IPSAS 38, <i>Disclosure of Interests in Other Entities</i>	Not assessed – fair value is not used in context of measurement guidance specific to this IPSAS		
IPSAS 39, <i>Employee Benefits</i>	Defined Benefit Plan Assets	Financial – like financial instruments, plan assets are held to earn revenues to settle the entity’s future obligations to its employees	Yes
IPSAS 40, <i>Combinations</i>	Acquisition	Operational – an entity controlled by controlling entity is generally for purposes of strategic initiatives and service provision	No
IPSAS 41, <i>Financial Instruments</i>	Financial Instruments measured at Fair Value	Financial – financial instruments held to generate financial return rather than to provide services	Yes
IPSAS 42, <i>Social Benefits</i>	Not assessed – term fair value is not used in core text		
[ED62] IPSAS XX, <i>Leases</i>	Not assessed – to be assessed in conjunction with Leases Task Force team		

IPSAS	Subtopic using Fair Value	Primary measurement objective	Is fair value appropriate for the subtopic?
[ED70] IPSAS XX, <i>Revenue with Performance Obligations</i>	Not assessed – to be assessed in conjunction with Revenue Task Force team		
[ED71] IPSAS XX, <i>Revenue without Performance Obligations</i>	Not assessed – to be assessed in conjunction with Revenue Task Force team		
[ED72] IPSAS XX, <i>Transfer Expenses</i>	Not assessed – to be assessed in conjunction with Revenue Task Force team		

The Financial Reporting under the Cash Basis of Accounting and the three RPGs were not included in this analysis as they were not relevant nor part of the core IPSAS.

Decision Required

Does the IPSASB agree with the Staff recommendation?

Fair Value – Improvements to Measurement Bases Guidance (Theme F)

Question

1. Does the IPSASB agree the fair value concerns identified by respondents have been appropriately addressed?

Recommendation

2. The Task Force recommends the non-conceptual concerns identified by respondents related to the fair value application guidance be actioned as noted in paragraph 4.

Background

3. At its March meeting, the IPSASB instructed its Task Force to review the non-conceptual concerns to determine whether they should be actioned in the Exposure Draft.

Analysis

4. Staff reviewed all non-conceptual issues related to fair value. The following table summarizes non-conceptual concerns by theme. Individual concerns are provided in [Appendix A](#):

Respondents' Concern	Proposed Action	Issue Number (see Appendix A)
Editorial Updates. Suggestions to enhance / clarify the text.	Update Fair Value Application Guidance as necessary <i>Complete as part of development of ED in Q3 2020.</i>	FV 1, FV 3, FV 4, FV 5, FV 12 and FV 13
Non-authoritative guidance. Develop IEs to help determine fair value.	Update Fair Value Application Guidance as necessary <i>Consider and develop Illustrative Examples and Implementation Guidance for ED in Q4 2020.</i>	FV 2
Other guidance available. Consider other standard setters fair value measurement guidance to enhance AGs.	Update Fair Value Application Guidance as necessary <i>Complete as part of development of ED in Q3 2020.</i>	FV 6
Fair value limitations. IFRS 13 fair value has some clear limitations in the public sector (e.g. highest and best use).	No action necessary The measurement basis "current cost" was developed specifically to address the limitations of measuring items at fair value in the public sector. For example, current cost does not consider the highest and best use in its measurement and is not an exit value.	FV 7 – FV 11

Decision Required

5. Does the IPSASB agree with Staff's recommendation?

Agenda Item 7.2.4

Appendix A – Fair Value (Summarized Responses)

1. Summary Description of Respondents Concerns (See [Supplemental Document 2](#) for Unedited Responses).

Issue Number	Summary Description	Task Force Recommendation
FV 1	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	Update Fair Value Application Guidance as necessary <i>Complete as part of development of ED in Q3 2020.</i>
FV 2	Develop illustrative examples to help public sector entities determine fair value in practice.	Update Fair Value Application Guidance as necessary <i>Consider and develop Illustrative Examples and Implementation Guidance for ED in Q4 2020.</i>
FV 3	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	Update Fair Value Application Guidance as necessary <i>Complete as part of development of ED in Q3 2020.</i>
FV 4		
FV 5		
FV 6	Consider the AASB's fair value measurement in the public sector project which may inform the IPSASB's deliberations.	Update Fair Value Application Guidance as necessary <i>Complete as part of development of ED in Q3 2020.</i>
FV 7	IFRS 13 fair value has some clear limitations in the public sector. The IPSASB should be explicit about the limitations of the use of fair value (e.g. concept of the highest and best use of an asset or an exit price concept and having to address the hypothetical market participant when often no such entity exists).	No action necessary <i>The measurement basis "current cost" was developed specifically to address the limitations of measuring items at fair value in the public sector. For example, current cost does not consider the highest and best use in its measurement and is not an exit value.</i>
FV 8		
FV 9		
FV 10		
FV 11		
FV 12	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	Update Fair Value Application Guidance as necessary <i>Complete as part of development of ED in Q3 2020.</i>
FV 13		

Fulfillment Value – Improvements to Measurement Bases Guidance (Theme F)

Question

1. Does the IPSASB agree the fulfillment value concerns identified by respondents have been appropriately addressed?

Recommendation

2. The Task Force recommends the non-conceptual concerns identified by respondents related to the fulfillment value application guidance be actioned as noted in paragraph 4.

Background

3. At its March meeting, the IPSASB instructed its Task Force to review the non-conceptual concerns to determine whether they should be actioned for the purposes of the Exposure Draft.

Analysis

4. Staff reviewed all non-conceptual issues related to fulfillment value. The following table summarizes non-conceptual concerns by theme. Individual concerns are provided in [Appendix A](#):

Respondents' Concern	Proposed Action	Issue Number (see Appendix A)
Risk premium. Consideration of whether it is appropriate to include a risk premium in current value measures for liabilities is necessary.	Issues Paper in Development The IPSASB identified this issue at its March 2020 meeting. Staff is developing an issues paper evaluating whether including a risk premium in the fulfillment value measure is appropriate in the public sector. The paper will be provided to the IPSASB in September 2020.	FV 1, FV 4 and FV 6
Least costly amount. When determining the fulfillment value, the least costly amount should be used, however it should be constrained by how the entity plans to settle the liability.	No action necessary The IPSAS concluded when an entity plans to settle a liability at an amount other than the least costly amount guidance in IPSAS 19 applies. As it relates to the specific obligations, the least costly amount is the most relevant information to the financial statement user. See paragraph B7 of CP.	FV 2
Editorial Updates. Suggestions to enhance / clarify the text.	Update Fulfillment Value Application Guidance as necessary <i>Complete as part of development of ED in Q3 2020.</i>	FV 3, FV 5, FV 7 and FV 9 - FV 12

<p>Fulfillment Value Appendix is unnecessary. Fulfillment value guidance should not be aggregated in one location. There is no issue with the current format in each standard.</p>	<p>No action necessary</p> <p>The IPSASB concluded guidance should be developed for the commonly applied measurement bases in IPSAS.</p> <p>The opposing view is supported by evidence the Board has previously considered.</p> <p>There is not a compelling argument to deviate from the view proposed.</p>	<p>FV 8</p>
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Decision Required

5. Does the IPSASB agree with Staff's recommendation?

Appendix A – Fulfillment Value (Summarized Responses)

1. Summary Description of Respondents Concerns (See [Supplemental Documents 3](#) for Unedited Responses).

Issue Number	Summary Description	Task Force Recommendation
FV 1	Consideration of whether it is appropriate to include a risk premium in current value measures for liabilities is necessary.	<p>Issues Paper in Development</p> <p>The IPSASB identified this issue at its March 2020 meeting. Staff is developing an issues paper evaluating whether including a risk premium in the fulfillment value measure is appropriate in the public sector. The paper will be provided to the IPSASB in September 2020.</p>
FV 2	When determining the fulfillment value, the least costly amount should be used, however it should be constrained by how the entity plans to settle the liability.	<p>No action necessary</p> <p>The IPSAS concluded when an entity plans to settle a liability at an amount other than the least costly amount guidance in IPSAS 19 applies. As it relates to the specific obligations, the least costly amount is the most relevant information to the financial statement user. See paragraph B7 of CP.</p>
FV 3	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	<p>Update Fulfillment Value Application Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>
FV 4	Consideration of whether it is appropriate to include a risk premium in current value measures for liabilities is necessary.	<p>Issues Paper in Development</p> <p>The IPSASB identified this issue at its March 2020 meeting. Staff is developing an issues paper evaluating whether including a risk premium in the fulfillment value measure is appropriate in the public sector. The paper will be provided to the IPSASB in September 2020.</p>
FV 5	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	<p>Update Fulfillment Value Application Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>

Issue Number	Summary Description	Task Force Recommendation
FV 6	Consideration of whether it is appropriate to include a risk premium in current value measures for liabilities is necessary.	<p>Issues Paper in Development</p> <p>The IPSASB identified this issue at its March 2020 meeting. Staff is developing an issues paper evaluating whether including a risk premium in the fulfillment value measure is appropriate in the public sector. The paper will be provided to the IPSASB in September 2020.</p>
FV 7	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	<p>Update Fulfillment Value Application Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>
FV 8	Fulfillment value guidance should not be aggregated in one location. There is no issue with the current format in each standard.	<p>No action necessary</p> <p>The IPSASB concluded guidance should be developed for the commonly applied measurement bases in IPSAS.</p> <p>The opposing view is supported by evidence the Board has previously considered.</p> <p>There is not a compelling argument to deviate from the view proposed.</p>
FV 9	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	<p>Update Fulfillment Value Application Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>
FV 10		
FV 11		
FV 12		

Historical Cost – Improvements to Measurement Bases Guidance (Theme F)

Question

1. Does the IPSASB agree the concerns with historical cost identified by respondents have been appropriately addressed?

Recommendation

2. The Task Force recommends the non-conceptual concerns identified by respondents related to the historical cost application guidance be actioned as noted in paragraph 4.

Background

3. At its March meeting, the IPSASB instructed its Task Force to review the non-conceptual concerns to determine whether they should be actioned for the purposes of the Exposure Draft.

Analysis

4. Staff reviewed all non-conceptual issues related to historical cost. The following table summarizes non-conceptual concerns by theme. Individual concerns are provided in [Appendix A](#):

Respondents' Concern	Proposed Action	Issue Number (see Appendix A)
Historical Cost Appendix is unnecessary. There is no issue with the current format in each standard.	No action necessary The IPSASB concluded guidance should be developed for the commonly applied measurement bases in IPSAS. The opposing view is supported by evidence the Board has previously considered. There is not a compelling argument to deviate from the view proposed.	HC 1 and HC 10
Borrowing costs. Guidance on borrowing costs should be included in historical cost guidance.	No action necessary IPSAS 5, <i>Borrowing Costs</i> , includes comprehensive borrowing cost guidance. Duplication is not necessary. Proposal to retain accounting policy choice is being retained in IPSAS 5 – See Agenda Item X.X.X.	HC 2
Liabilities. Historical cost is applicable to liabilities.	Update Historical Cost Application Guidance The historical cost application guidance in the CP focused on assets. As this is generic guidance it should be updated for liabilities. <i>Complete as part of development of ED in Q3 2020.</i>	HC 3, HC 9, HC 12 and HC 13
Editorial Updates. Suggestions to enhance / clarify the text.	Update Historical Cost Application Guidance <i>Complete as part of development of ED in Q3 2020.</i>	HC 4, HC 5, HC 8, HC 11 and HC 14

<p>Derived text. Guidance in the appendix should not be derived from the conceptual framework or basis for conclusions.</p>	<p>No action necessary</p> <p>The source of the text is not relevant in determining whether it is useful for constituents applying IPSAS, Measurement. In developing IPSAS, Measurement, text was derived from several sources based on whether it clarified how to apply measurement bases in practice.</p>	<p>HC 6 and HC 7</p>
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Decision Required

5. Does the IPSASB agree with Staff's recommendation?

Appendix A – Historical Cost (Summarized Responses)

1. Summary Description of Respondents Concerns (See [Supplemental Documents 4](#) for Unedited Responses).

Issue Number	Summary Description	Task Force Recommendation
HC 1	<p>Historical Cost Appendix is unnecessary:</p> <ul style="list-style-type: none"> - there is little or no generic application guidance needed; and - moving guidance would result in unnecessary changes and unnecessary differences between IPSAS and IFRS Standards. 	<p>No action necessary</p> <p>The IPSASB concluded guidance should be developed for the commonly applied measurement bases in IPSAS.</p> <p>The opposing view is supported by evidence the Board has previously considered.</p> <p>There is not a compelling argument to deviate from the view proposed.</p>
HC 2	<p>Guidance on borrowing costs should be included in historical cost guidance.</p>	<p>No action necessary</p> <p>IPSAS 5, <i>Borrowing Costs</i>, includes comprehensive borrowing cost guidance. Duplication is not necessary.</p>
HC 3	<p>Historical cost is applicable to liabilities.</p>	<p>Update Historical Cost Application Guidance</p> <p>The historical cost application guidance in the CP focused on assets. As this is generic guidance it should be updated for liabilities.</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>
HC 4	<p>Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.</p>	<p>Update Historical Cost Application Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>
HC 5	<p>Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.</p>	<p>Update Historical Cost Application Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>

Issue Number	Summary Description	Task Force Recommendation
HC 6	Text in application guidance should not be derived from IASB BCs.	<p>No action necessary</p> <p>Whether IASB BCs are authoritative or not is not relevant when the IPSASB develops text. BCs used as a basis for IPSAS, Measurement text were deemed to be relevant for public sector entities.</p>
HC 7	Text in application guidance should not be derived from the conceptual framework	<p>No action necessary</p> <p>Whether guidance included in IPSAS, measurement is derived from the conceptual framework is not relevant in determining whether it is useful for constituents applying IPSAS, Measurement. In developing IPSAS, Measurement, text was derived from several sources based on whether it clarified how to apply measurement bases in practice.</p>
HC 8	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	<p>Update Historical Cost Application Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>
HC 9	Historical cost is applicable to liabilities.	<p>Update Historical Cost Application Guidance</p> <p>The historical cost application guidance in the CP focused on assets. As this is generic guidance it should be updated for liabilities.</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>
HC 10	Historical cost guidance should not be aggregated in one location. There is no issue with the current format in each standard.	<p>No action necessary</p> <p>The IPSASB concluded guidance should be developed for the commonly applied measurement bases in IPSAS.</p> <p>The opposing view is supported by evidence the Board has previously considered.</p> <p>There is not a compelling argument to deviate from the view proposed.</p>

Issue Number	Summary Description	Task Force Recommendation
HC 11	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	<p>Update Historical Cost Application Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>
HC 12	Historical cost is applicable to liabilities.	<p>Update Historical Cost Application Guidance</p> <p>The historical cost application guidance in the CP focused on assets. As this is generic guidance it should be updated for liabilities.</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>
HC 13	Historical cost is applicable to liabilities.	<p>Update Historical Cost Application Guidance</p> <p>The historical cost application guidance in the CP focused on assets. As this is generic guidance it should be updated for liabilities.</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>
HC 14	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	<p>Update Historical Cost Application Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>

Replacement Cost – Improvements to Measurement Bases Guidance (Theme F)

Question

1. Does the IPSASB agree the replacement cost concerns identified by respondents have been appropriately addressed?

Recommendation

2. The Task Force recommends the non-conceptual concerns identified by respondents related to the replacement cost application guidance be actioned as noted in paragraph 4.

Background

3. At its March meeting, the IPSASB instructed its Task Force to review the non-conceptual issues to determine whether they should be actioned for the purposes of the Exposure Draft.

Analysis

4. Staff reviewed all non-conceptual issues related to replacement cost. The following table summarizes non-conceptual concerns by theme. Individual concerns are provided in [Appendix A](#):

Respondents' Concern	Proposed Action	Issue Number (see Appendix A)
Differentiate between technique and basis. Clearly differentiate between the use of the cost approach to determine fair value and replacement cost as a separate measurement basis	Issues Paper Developed (See Paper 1) <i>The proposed measurement hierarchy proposes that replacement cost is a measurement technique. This eliminates the inconsistency.</i>	RC 1, RC 3, RC 5, RC 9, RC 10, RC 12 and RC 15
Insufficient guidance. There is insufficient guidance currently for replacement cost	Update Replacement Cost Guidance as necessary <i>Comment is primarily addressed by applying the proposed hierarchy. Under the proposed hierarchy, replacement cost is a measurement technique. Depending on the basis RC is estimating many of the issues identified are addressed based on the measurement objective of the measurement basis.</i>	RC 2 and RC 7
Highest and best use. Applying Highest and Best Use when measuring replacement cost is not appropriate in the public sector	No action necessary <i>Comment is addressed by applying the proposed hierarchy. Under the proposed hierarchy, replacement cost is a measurement technique. When RC is used to estimate Fair Value, Highest and Best use is applied. When RC is used to estimate Current Cost, the current use of the asset is considered.</i>	RC 4

Editorial Updates. Suggestions to enhance / clarify the text.	Update Replacement Cost Guidance as necessary <i>Complete as part of development of ED in Q3 2020.</i>	RC 6, RC 11, RC 13, RC 14 and RC 16
Specialized Assets. More specific application guidance should be provided for specialized assets/infrastructure assets	No action necessary <i>Specific measurement guidance is provided in specific IPSAS. Guidance on infrastructure assets will be provided in IPSAS 17.</i>	RC 8

Decision Required

5. Does the IPSASB agree with Staff's recommendation?

Appendix A – Replacement Cost (Summarized Responses)

1. Summary Description of Respondents Concerns (See [Supplemental Documents 5](#) for Unedited Responses).

Issue Number	Summary Description	Task Force Recommendation
RC 1	Clearly differentiate between the use of the cost approach to determine fair value and replacement cost as a separate measurement basis	<p>Issues Paper Developed (See Paper 1)</p> <p>The proposed measurement hierarchy proposes replacement cost is a measurement technique. This eliminates the inconsistency.</p>
RC 2	Application guidance that accompanies PBE IPSAS 17 more clearly addresses some of the issues identified in Appendix D – Replacement Cost.	<p>Update Replacement Cost Guidance as necessary</p> <p>Review PBE IPSAS 17 and determine whether to incorporate guidance into Replacement Cost guidance.</p>
RC 3	Clearly differentiate between the use of the cost approach to determine fair value and replacement cost as a separate measurement basis	<p>Issues Paper Developed (See Paper 1)</p> <p><i>The proposed measurement hierarchy proposes replacement cost is a measurement technique. This eliminates the inconsistency.</i></p>
RC 4	Applying Highest and Best Use when measuring replacement cost is not appropriate in the public sector	<p>No action necessary</p> <p><i>Comment is addressed by applying the proposed hierarchy.</i></p> <p><i>Under the proposed hierarchy, replacement cost is a measurement technique. When RC is used to estimate Fair Value, Highest and Best use is applied. When RC is used to estimate Current Cost, the current use of the asset is considered.</i></p>
RC 5	Clearly differentiate between the use of the cost approach to determine fair value and replacement cost as a separate measurement basis	<p>Issues Paper Developed (See Paper 1)</p> <p><i>The proposed measurement hierarchy proposes replacement cost is a measurement technique. This eliminates the inconsistency.</i></p>
RC 6	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	<p>Update Replacement Cost Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>

Issue Number	Summary Description	Task Force Recommendation
RC 7	<p>There is insufficient guidance currently for replacement cost for:</p> <ul style="list-style-type: none"> - determining the unit of account when valuing assets (e.g. to what extent should land and non-land assets be disaggregated for the purpose of selecting the appropriate valuation stream), - considering the impact of legal and physical restrictions on current replacement cost, - deciding which costs to include in the replacement cost (especially in situations where part of an asset rather than the entire asset is replaced), - determining economic obsolescence and temporary overcapacity, and - when using current replacement cost, adjusting for differences in utility between existing assets and the modern equivalent. 	<p>Update Replacement Cost Guidance as necessary</p> <p>Comment is primarily addressed by applying the proposed hierarchy.</p> <p>Under the proposed hierarchy, replacement cost is a measurement technique. Depending on the basis RC is estimating many of the issues identified are addressed based on the measurement objective of the measurement basis.</p>
RC 8	<p>More specific application guidance should be provided for specialized assets/infrastructure assets.</p>	<p>No action necessary</p> <p><i>Specific measurement guidance is provided in specific IPSAS. Guidance on infrastructure assets will be provided in IPSAS 17.</i></p>
RC 9	<p>Clearly differentiate between the use of the cost approach to determine fair value and replacement cost as a separate measurement basis</p>	<p>Issues Paper Developed (See Paper 1)</p> <p><i>The proposed measurement hierarchy proposes replacement cost is a measurement technique. This eliminates the inconsistency.</i></p>
RC 10	<p>Clearly differentiate between the use of the cost approach to determine fair value and replacement cost as a separate measurement basis</p>	<p>Issues Paper Developed (See Paper 1)</p> <p><i>The proposed measurement hierarchy proposes replacement cost is a measurement technique. This eliminates the inconsistency.</i></p>
RC 11	<p>Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.</p>	<p>Update Replacement Cost Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>

Issue Number	Summary Description	Task Force Recommendation
RC 12	Clearly differentiate between the use of the cost approach to determine fair value and replacement cost as a separate measurement basis	<p>Issues Paper Developed (See Paper 1)</p> <p><i>The proposed measurement hierarchy proposes replacement cost is a measurement technique. This eliminates the inconsistency.</i></p>
RC 13	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	<p>Update Replacement Cost Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>
RC 14	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	<p>Update Replacement Cost Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>
RC 15	Clearly differentiate between the use of the cost approach to determine fair value and replacement cost as a separate measurement basis	<p>Issues Paper Developed (See Paper 1)</p> <p><i>The proposed measurement hierarchy proposes replacement cost is a measurement technique. This eliminates the inconsistency.</i></p>
RC 16	Suggestions to enhance / clarify the text proposed in the illustrative exposure draft.	<p>Update Replacement Cost Guidance as necessary</p> <p><i>Complete as part of development of ED in Q3 2020.</i></p>

Amendments to IPSAS 5: Borrowing Costs (For Information Purposes Only)

Members are requested to review the proposed changes to IPSAS 5 out of session and provide any comments to Staff⁷, with target approval in September 2020.

Question

1. Does the IPSASB agree with the guidance added to IPSAS 5, *Borrowing Costs*?

Recommendation

2. Staff recommend the BCs distinguishing between borrowing costs and transaction costs be included.
3. Staff recommend the following IG and IEs be added in IPSAS 5, *Borrowing Costs*. See Appendix A for marked up document.

Issue	Issue Type	IE	IG
Timing of Qualifying Assets	Qualifying Asset	IE1-IE3 Timing of Qualifying Assets	A.1 Timing of Qualifying Assets
Limit on Capitalization		-	A.2 Timing of Qualifying Assets
(a) Centralized Borrowing Program – Unknown Source of Funds	Directly Attributable	IE4-IE8 Eligible Borrowing Costs	A.3 Unknown Source of Funds
(b) Centralized Borrowing Program – Interest Rates			A.4 Interest Rates
(c) General Borrowing – Borrowings are not Specific to Qualifying Asset		IE9-IE12 Weighted Average Cost of Borrowing	A.5 Borrowings are not Specific to Qualifying Asset
			A.6 Range of Debt Instruments

Background

4. Staff provided a detailed review of responses to the Measurement CP at the IPSASB March 2020 meeting.

⁷ Members with editorial interest in this document will be invited to provide comments to staff. The final document will be brought back to the IPSASB in September 2020.

5. Due to the split in responses in respect of Preliminary View–Chapter 3⁸, Staff recommended retaining the accounting policy choice to expense or capitalize borrowing costs. Staff developed amendments to IPSAS 5 for the IPSASB to consider:
 - (a) Basis for Conclusions detailing why the IPSASB has maintained its accounting policy choice; and
 - (b) Application Guidance to clarify the terms “qualifying asset” and “direct expenditure”.
6. Members agreed to retain the accounting policy choice and instructed Staff to:
 - (a) Develop Basis for Conclusions to distinguish between borrowing costs and transaction costs; and
 - (b) Replace the proposed Application Guidance (AG) with Illustrative Examples (IE) and Implementation Guidance (IG) to clarify the terms “Qualifying Asset” and “Directly Attributable”.

Analysis

Transaction Costs / Borrowing Costs

7. Some respondents noted either:
 - (a) Borrowing costs to be a type of transaction costs; or
 - (b) Transaction costs to be a type of borrowing costs.
8. Borrowing costs are interest and other expenses incurred by an entity in connection with borrowing funds. They are often contractually linked to the underlying borrowing. For example, the interest rate is a characteristic of the debt instrument.
9. Transaction costs are incremental costs that are directly attributable to the transaction. They are independent of the contractual terms of the instrument. For example, the costs to transport an asset from the seller’s location to the buyer is independent from the asset.
10. This is a key difference between the costs. As such, it is appropriate for the accounting principles to differ. The differing facts and circumstances may result in differing accounting for transaction and borrowing costs.

Illustrative Examples / Implementation Guidance

11. Staff has actioned the IPSASB instruction to replace all the proposed Application Guidance with Implementation Guidance and Illustrative Examples. For the sake of clarity, this change to the March 2020 document has been ‘accepted’ – that is, it is not shown in mark-up in the revised ED presented to the IPSASB with this Issues Paper.
12. In developing the IG and IEs, Staff reviewed the CP and Responses to the CP and identified three specific issues:
 - (a) Centralized Borrowing Program – Unknown Source of Funds

⁸ 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.

Centralized borrowing programs use several sources including tax revenue, debt and other fees. The entity borrowing from the centralized borrowing agency is unaware which source of funding is used by the lender to fund the loan. This creates challenges in determining the appropriate rate of borrowing.

(b) Centralized Borrowing Program – Interest Rates

Centralized borrowing programs use several loan instruments. The entity borrowing from the centralized borrowing agency is unaware of the interest rate associated with these instruments. This creates challenges in determining the appropriate rate of borrowing.

(c) General Borrowing – Borrowings are not Specific to Qualifying Asset

Entities borrowing for their own purposes borrow for general purposes. It is difficult to determine the borrowing costs when funds used to pay for the cost of the qualifying asset come from a pool of cash.

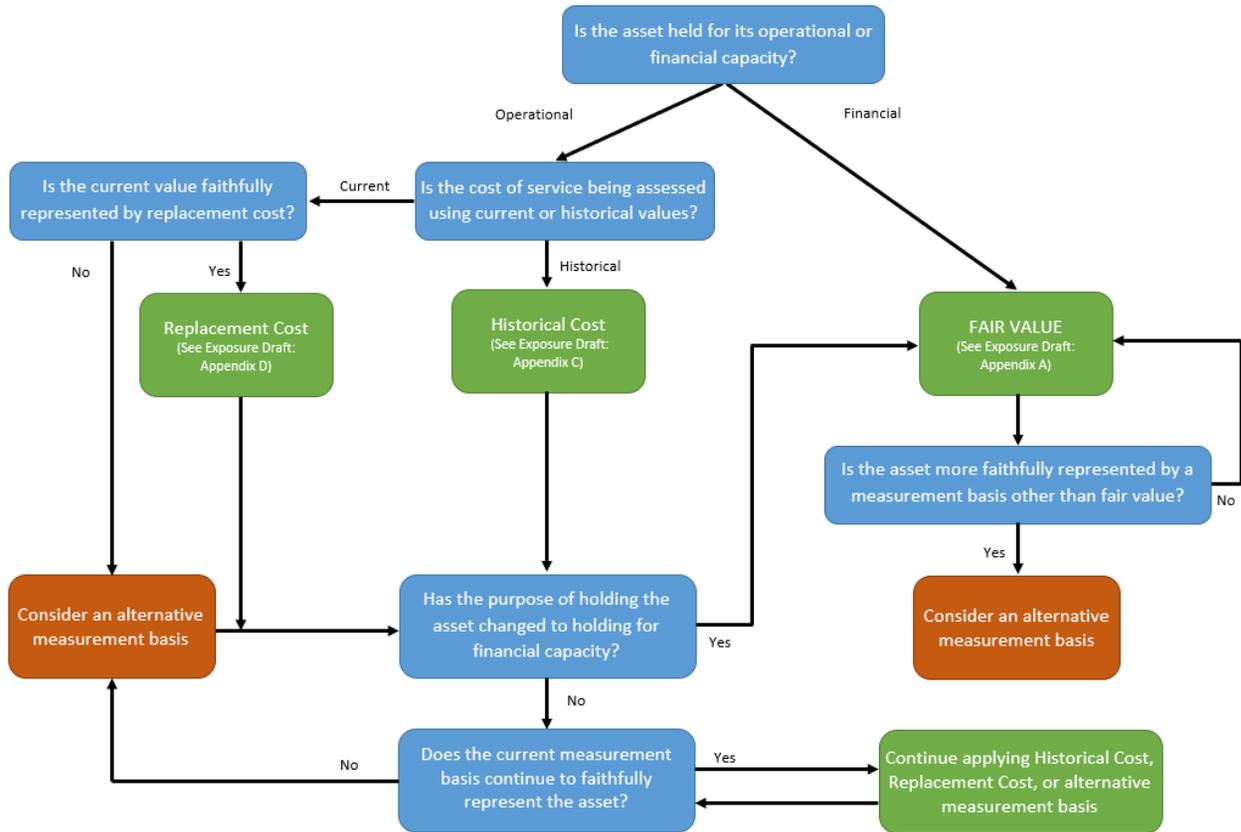
13. All issues identified relate to the interpretation of whether borrowings are **directly attributable** to the asset being acquired, constructed or produced. No issues were specifically identified related to the interpretation of qualifying assets. However, Staff identified qualifying assets guidance in the proposed AGs that was repurposed as IE and IGs.

Decision Required

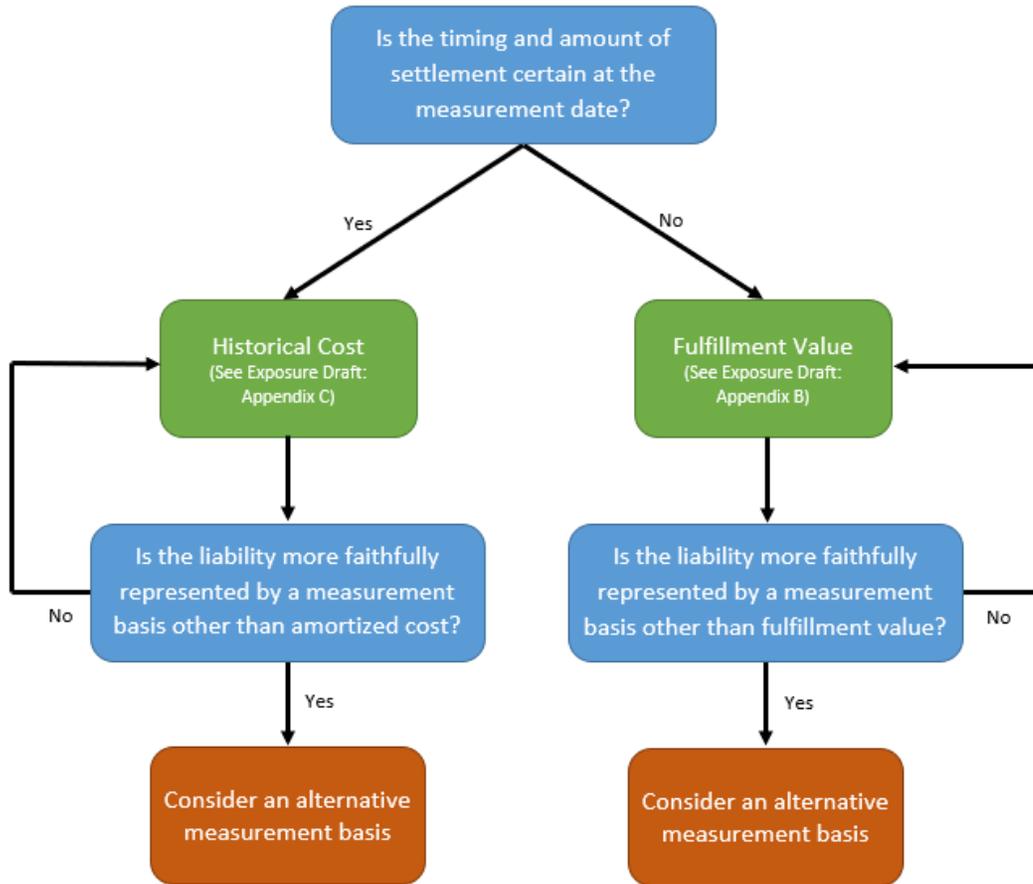
14. Does the IPSASB agree with the Staff recommendation?

Supporting Documents 1: Measurement Methodology Flow Charts

Measurement (Assets)



Measurement (Liabilities)



* a decision has been made in how the liability will be funded / settled
** liabilities arising from operations for which the method of settlement must still be determined

Supporting Documents 2 - Fair Value (Unedited Responses)

Issue Number	Respondent	Issue
FV 1	04	<p>Addendum C of the CP shows that the IPSASB has not included the IFRS 13 guidance on non-performance risk (paragraphs 42 to 45 of IFRS 13) in the illustrative ED. Addendum C indicates that this guidance is potentially to be included in IPSAS 41 Financial Instruments. In the absence of a Basis for Conclusions outlining why the IPSASB has decided not to include such guidance in the illustrative ED and the IPSASB's views about the impact of omitting such guidance from the proposed measurement standard, we cannot form a view on whether this omission is appropriate.</p>
FV 2	04	<p>Experience in applying IFRS 13</p> <p>Although IFRS 13 Fair Value Measurement was developed for application by entities applying IFRS Standards, the majority of which have a profit objective, public sector entities in some jurisdictions, such as Australia and the United Kingdom, have also been required to apply IFRS 13 or equivalent requirements to certain assets. The way in which the relevant assets have been specified, the implementation issues encountered and the response of standard setters to those issues could inform discussions as the IPSASB moves forward with this project.</p> <p>The AASB is currently looking at some issues associated with the application of AASB 13 Fair Value Measurement to public sector not-for-profit entities which may be of interest to the IPSASB. The AASB is proposing to develop illustrative examples to help public sector entities determine current replacement cost in accordance with AASB 13. The AASB has also been deliberating on whether the fair value of assets held for their service capacity should be determined differently from those assets held primarily for their ability to generate net cash inflows.</p>

Issue Number	Respondent	Issue
FV 3	07	<p>If the cost approach is retained, we have the following comment on paragraph A19 - Paragraph D5 explains that a particular asset may need to be situated in a particular location because of legal or social policy decisions. It might be helpful to include a similar discussion in A19 as this is likely to be a reason for not being able to use a non-financial asset for its highest and best use.</p> <p>Paragraph A22(a)(i) - It might be helpful to include a reference to heritage assets as collections of heritage assets are often an example where the collection may have more value than the sum of the individual assets.</p> <p>Paragraph A29 - The list outlines examples when the transaction price of an asset or liability may be different to the fair value at acquisition. It might be helpful to include in the list that an entity may not charge a market related rate to achieve specific social policy objectives, e.g. the issuing of concessionary loans or financial guarantees where no or a nominal fee is charged.</p> <p>Paragraph A39 - There is no mention in A39 or A40 of the inclusion of the proceeds from the disposal of the asset at the end of its life in the valuation (as is the case when replacement cost is discussed in Appendix D). If the cost approach is retained, we have the following comments on paragraph A40 - It is unclear whether the determination of replacement cost in this appendix is on an 'optimised' basis or not (as is the case in Appendix D). It would be helpful if the differences between how replacement cost is defined and discussed in Appendix A and Appendix D could be compared, differences identified, and resolved. If they are meant to be determined on the same basis, then Appendix A should refer to Appendix D.</p> <p>Use of fair value</p> <ul style="list-style-type: none"> • At present, the IPSASB's Conceptual Framework for General Purpose Financial Reports in the Public Sector does not include 'fair value' as defined in IFRS 13 on Fair Value Measurement as a measurement basis. • We agree that, in order to maintain alignment with International Financial Reporting Standards, the IPSASB needs to include 'fair value' in its literature. However, we question how it will be used and its interaction with other measurement bases such as 'market value' and 'replacement cost'. • Fair value, as defined in IFRS 13 is an exit-based measure of assets and liabilities. It is therefore only likely to be relevant when measuring the financial capacity of assets. • Given our limited support for the use of fair value in IPSAS, this would impact on the modification of IFRS Standards when they are developed as an IPSAS. This would particularly be the case where an IFRS Standard proposes using fair value to measure the 'operational capacity' of an asset. As a result, there may be some need for divergence from IFRS regarding the use of fair value.

Issue Number	Respondent	Issue
FV 4	13	<p>1. A6 of Appendix A of the CP states that “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”. An asset or liability “exchanged in an orderly transaction between market participants” could be interpreted to exclude non-exchange transactions. Non-exchange transactions are quite common in the public sector. As described in Paragraph 27 of IPSAS 16 Property, Equipment and Plant, nonexchange transactions are commonly entered in the public sector and must be measured at fair value. Therefore, we propose that the IPSASB should clarify that the requirements concerning fair value include “non-exchange transactions.”</p> <p>2. To help constituents consider the preliminary view, we request that the ED include a cross reference to the requirements of IFRS 13 that are relevant, in addition to AG. The Basis for Conclusion should clarify why the requirements in Paragraphs 34 to 56 and Paragraphs 70 to 71 were excluded.</p>
FV 5	14	<p>We recommend that more application guidance is provided in relation to highest and best use for non-financial assets (A18 to A21). We believe that paragraph A21 over-simplifies the fact that in the public sector there will be hard and soft restrictions in place that will prevent some entities from accessing the highest and best market. Example of a hard restriction could be legislation or a restrictive covenant over an asset, whilst a soft restriction could be the need to deliver public services in a particular geographic location which requires assets to be owned in those locations.</p>
FV 6	15	<p>We encourage the IPSASB to consider the AASB’s fair value measurement in the public sector project which may inform the IPSASB’s deliberations as the AASB is addressing specific issues raised by public sector constituents.</p>
FV 7	16	<p>However, we see that the use of fair value in the understanding of IFRS 13 has some clear limitations in the public sector. The IPSASB should therefore be more explicit about the limitations of the use of fair value (e.g. concept of the highest and best use of an asset) in the public sector (either in the standard on Measurement or in a revised Conceptual Framework).</p>
FV 8	20	<p>Although GA/CFC shares the view that fair value as defined in IFRS 13 is relevant, we believe that measuring the fair value of some non-financial assets held by public sector entities based on its highest and best use by market participants is controversial, because it may not appropriately reflect the relevant service potential of asset to the public sector entity (indeed, in order to achieve the public interest, an entity may intend not to use the asset according to its highest and best use).</p>
FV 9	22	<p>Fair value guidance should be aligned as far as possible with IFRS 13. One exception would be ‘highest and best use’, which should be adapted to the public sector context.</p>

Issue Number	Respondent	Issue
FV 10	24	<p>I believe that there are some gaps in the guidance. The revaluation of PPE seems to assume the replacement cost approach.</p> <p>In many situations of infrastructure assets, like roads this makes sense. However, we have numerous infrastructure assets in GBE's, for example electricity (generation, transmission and distribution), ports and water (generation (such as dams, recycling and desalination plants,) transmission and distribution). The GBE assets are valued on a net present value (fair value) basis in their own financial statements, and also on consolidation. My experience is that a replacement cost approach for these assets are a huge cost burden, and do not result in a value that is anywhere near the NPV value.</p> <p>I believe that such assets should be valued on an NPV approach, being either fair value or something close to it. However, we have encountered many practical problems with fair valuing such assets. One major problem is related to the exit price concept and having to address the hypothetical market participant when often no such entity exists. I would like to see fair value being used, i.e. using expected cash flows from operating the asset, without the additional complexities and cost burdens of the non-existent hypothetical market participant.</p> <p>While these assets are often subject to regulatory regimes and price capping, these caps are set for a maximum of five years into the future. Then estimates need to be made of the future price caps from the end of the regulatory period for tens of years into the future.</p> <p>Fair value works well with level 1 or level 2 valuations, e.g. social housing where there are markets for similar residential housing.</p>

FV 11	28	<p>More generally, the application of fair value in a public sector context creates particular difficulties in its application to non-financial assets and to liabilities where there is no direct evidence of a market price from which fair value should be determined. Such difficulties seem to be compounded because IFRS 13 does not always distinguish clearly between ‘measurement’, which requires an observable attribute, and ‘estimation’, which relies upon a subjective extrapolation from observable data (Barker and McGeachin, 2013)¹³. In circumstances where there is no active market for the precise type of assets or liabilities being ‘measured’, the fair value approach may rely upon a hypothetical valuation, which does not exist and does not represent the institutional reality of public sector bodies (for a private sector perspective see Barker and Schulte, 2017)¹⁴. If there are problems with IFRS 13 in the private sector, the prospects of its application in a public sector setting are not very encouraging.</p> <p>The following are some examples in Appendix A that may present difficulties (in the sense that they would present a series of bones of contention when attempting to apply them to the public sector context):</p> <p>a) A18 – “A fair value measurement of a non-financial asset takes into account a market participant’s ability to generate economic benefits by using the asset in its highest and best use ...”. It is argued that the highest and best use for a non-financial asset in the public sector may be social and/or cultural and may not even involve economic benefits. This problem is acknowledged by the IPSASB (par. 2.23, page 20). In addition, the interpretation of the market participants’ perspective, through which “highest and best use” is determined, could be influenced by political reasons. Such situations may lead to fictitious values being used under Fair Value measurement (Barker and Schulte, 2017).</p> <p>b) A21 – requires an entity to measure the fair value of a non-financial asset assuming its highest and best use by market participants even if the entity does not intend to use the asset according to its highest and best use. We believe that this may be a rather misleading way to value public sector assets because of the ambiguous message that the valuation would be providing, which may have dangerous political and social consequences.</p> <p>c) A22 (ii) – requires the valuation of the non-financial asset to “include liabilities that fund working capital, but do not include liabilities to fund assets other than those within the group of assets”. In a public sector context, however, most often it would be difficult to identify liabilities in this way because borrowing is usually done to finance operations in a general way and not to finance a particular group of assets. For example, the French law forbids attaching taxation revenues to specific uses of collected funds. Also in Germany, by definition, the nature of taxes refers to the taxation object without any consequences for their use (this is the main difference between taxes and fees in Germany).</p> <p>d) A28 – requires that, on initial recognition, the difference between fair value and the transaction price is recognized in surplus/deficit (unless the particular IPSAS states otherwise). It may be argued that introducing such subjectivity, immediately at the point of recognition of an asset/liability, would cast a rather ‘shady’ doubt on the accountability of the reporting entity. Most often, this amount would not be realized or realizable, undermining the users’ need to understand and assess public sector entity financial sustainability.</p> <p>e) A42 onwards – refer to present value techniques, which would require the establishment of a discount factor. It may be argued that it is rather difficult and hazardous to establish an appropriate discount factor in the public sector context, in particular for more governmental- type of entities. It raises unaddressed concerns with pro-cyclical effects and self-fulfilling prophecies that were experienced already in the private</p>
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Issue Number	Respondent	Issue
		<p>sector (Biondi, 2012). The use of discount factors would introduce a high level of subjectivity, especially when measuring long-term liabilities like pension obligations, as illustrated by the UK case study (Biondi, 2016). In order to reduce such subjectivity, a discounting regulation was released in Germany, for the private sector, specifying the method which the German Bundesbank should apply when calculating discount rates for the valuation of pensions. In the public sector (Standards staatlicher Doppik, which can be applied on Federal [central] or state [Länder] Level), an institution has been set up to prescribe discount factors for provisions that are adjusted on an annual basis. Such developments at country level make the requirement of IPSAS guidance more important for the sake of comparability.</p> <p>f) A89 – “An entity’s intention to hold the asset or to settle or otherwise fulfil the liability is not relevant when measuring fair value because fair value is a market-based measurement, not an entity-specific measurement.” Similar arguments as in (b) and (d) apply.</p> <p>The valuation techniques mentioned in A37 and A38 are quite technical. Some examples to illustrate their application in a public sector context would be appreciated.</p> <p>We agree with the stance taken by the IPSASB as to how to deal with fair value, as described in footnote 29 (page 35). In its evaluation, the IPSASB should take into consideration the discussions and issues that have already been highlighted by the UK FRAB in its attempt to adapt IFRS 13 for the public sector context.</p>
FV 12	29	HoTARAC recommends that the application guidance considers circumstances in which it may be difficult for public sector entities to apply. For example, it can be difficult to apply the concept of a principal market when there is no market for many public sector assets.
FV 13	31	Editorial Note: In paragraph A31, consider if “A41-A42” should be replaced with “A36-A42”.

Supporting Documents 3 - Fulfillment Value (Unedited Responses)

Issue Number	Respondent	Issue
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<p>FV 1</p>	<p>04</p>	<p>There is a risk that the proposed measurement standard will inappropriately stray into Conceptual Framework territory. It also runs the risk of inappropriately limiting future standards-level discussions or conflicting with current standards. For example, the IPSASB’s views on the appropriateness of a risk premium in current value measures for liabilities needs to be thought through before developing any generic guidance. If the IPSASB considers that a risk premium might not be appropriate in some instances, then both the measurement bases identified and any generic guidance relating to that measurement basis should reflect this. The review of the Conceptual Framework needs to occur before, or at the same time as the development of the measurement standard, to make sure that the guidance is both appropriate and appropriately located.</p> <p>The CP proposes to update the term cost of fulfilment currently applied in the IPSASB Conceptual Framework with fulfilment value. The CP states that this is to align with the terminology used in the IASB 2018 Conceptual Framework. Our view is that this is not merely a change in terminology. The illustrative ED proposes that fulfilment value should include a risk premium (also referred to as a risk adjustment). Although, the IPSASB Conceptual Framework is silent on this matter, the Basis for Conclusions on IPSAS 42 Social Benefits states that cost of fulfilment does not include a risk adjustment. The appropriateness of including a risk margin for the liabilities of public sector entities has been the subject of much debate in New Zealand. We think the IPSASB needs to consider in more detail whether it wants to adopt a measurement basis that includes a risk premium, why a risk premium is (or is not) appropriate, how the risk premium should be calculated (in general terms) and any implications for existing standards.</p> <p>Fulfilment value, as described in the IASB 2018 Conceptual Framework, includes a risk premium. The risk premium (for a liability) is described as being “the price for bearing the uncertainty inherent in the cash flows”. Paragraph 6.20 of the IASB 2018 Conceptual Framework clarifies that in the case of fulfilment value the risk premium is determined from an entity-specific perspective whereas in the case of fair value it is determined from a market-participant perspective.</p> <p>Appendix B of the CP indicates that the fulfilment value of a liability is to include a risk premium (see paragraphs B12–B13 and B37 shown below – emphasis added).</p> <p>B12. The fulfillment value is an entity specific value. An entity shall measure the fulfillment value of a liability using the assumptions from the entity’s perspective, assuming the entity acts in its own economic best interest.</p> <p>B13. In developing those entity-specific assumptions, an entity shall identify characteristics specific to the entity and the liability, considering factors specific to all the following:</p> <ul style="list-style-type: none"> (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
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Issue Number	Respondent	Issue
		<p>(d) The risk that the actual outflow of resources may ultimately differ from those expected (i.e., a risk premium).</p> <p>...</p> <p>B37. An entity shall apply judgement when determining an appropriate risk adjustment technique to use. If a risk premium were not included, the measurement would not faithfully represent the cost to fulfill the liability. In some cases determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is not a sufficient reason to exclude a risk premium.</p> <p>This contrasts with the description of cost of fulfilment in the IPSASB Conceptual Framework which does not mention a risk premium. It also conflicts with the Basis for Conclusions on IPSAS 42 Social Benefits (see paragraph BC152 shown below) which states that cost of fulfilment does not include a risk adjustment.</p> <p>BC152. The IPSASB sought the views of respondents to the CP regarding a risk adjustment. Respondents generally considered that the cost of fulfillment measurement basis, which does not include a risk adjustment, was the most appropriate measurement basis for social benefits.</p> <p>Given that the inclusion of a risk premium or risk adjustment in liability measures has been a much debated topic in the public sector, the IPSASB needs to critically assess whether it wants to adopt a measurement basis that includes a risk premium, why a risk premium is appropriate, and from whose perspective the risk premium should be calculated.</p> <p>Any change in the IPSASB's views about the appropriateness of a risk premium in an entity-specific liability measure would be a significant change that should be highlighted in due process documents.</p> <p>In addition to wanting to know why the IPSASB is proposing to make this change, we would need to see the proposed amendments to other standards that could be affected by this change, such as IPSAS 19 Provisions, Contingent Liabilities and Contingent Assets and IPSAS 39 Employee Benefits, before we could comment on the appropriateness of this guidance.</p>
FV 2	07	<p>Paragraph B10 indicates that the costs of contracting with an external party are only relevant where employing a contractor is the least costly means of fulfilling the obligation. It could be onerous to determine what the potential cost would be to settle the liability internally and seems impractical if an entity is not able to fulfil the obligation using internal capacity. The measurement of liabilities on this basis also does not appear to provide users of the financial statements with relevant information as the entity will record a liability at a lower amount when it knows that it will not settle it in the manner on which the measurement is determined. While we agree that the least costly amount should be used, it should be constrained by how the entity plans to settle the liability.</p>

Issue Number	Respondent	Issue
FV 3	07	<p>The linkages between this Appendix and existing Standards is unclear. Will the text explaining fulfilment value be removed from IPSAS 19 and IPSAS 42?</p> <p>Paragraph B1(c) - Is it necessary to separately list the timing of settlement? This is inherently part of the valuation technique.</p> <p>Paragraph B14 - Consider deleting the last sentence as it does not add anything. If this sentence is deleted, consider combining B14 and B15.</p> <p>Paragraph B22 - Reference is made to the 'current counterparty'. The counterparty may not be known, which is often the case for provisions. An example is the payment of contractors for a remediation liability. The specific contractors may not be known when the provision is recognised so the identification of the 'current counterparty' seems impractical.</p> <p>Heading: 'Income Approach' – consider changing the formatting as the next discussion on 'present value techniques seems to be part of the 'income approach'.</p> <p>Paragraph B36 - For (b), consider changing the term 'contracts' to 'liabilities'.</p> <p>Paragraph B48 - Reference is made to 'current information at the end of the reporting period' – This implies that estimates are only made at year end which may not always be the case (e.g. public sector combinations).</p>

<p>FV 4</p>	<p>11</p>	<p>Risk adjustment</p> <p>The rationale for a risk adjustment stated in paragraph B33 of Appendix B is that “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 the liability”. We note that IPSAS 1 Presentation of Financial Statements requires disclosures about the sources of measurement uncertainty; this requirement already provides users with additional information on estimates that is useful for accountability and decision-making.</p> <p>We understand that the purpose of the proposed risk premium is to adjust the liability to reflect the amount of compensation the entity would require so that it is indifferent between variable and fixed cash flows. However, adding a risk premium results in an estimation of the liability that is at the higher end of a range rather than a central estimate. Consequently, we question whether the risk premium provides faithfully representative and relevant information to users about the extent of the entity’s obligations to be settled in the future:</p> <p>In general, we find the guidance in the illustrative ED on the risk premium for fulfillment value to be overly complex and lacking in clarity.</p> <p>We believe that adding a risk premium may conflict with the objective of the fulfillment value measurement basis, which is to reflect the costs the entity will incur in fulfilling the obligation, assuming it does so in the least costly manner. Where the fulfillment value 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.</p> <p>In our opinion, adding a risk premium does not reflect the least costly manner to fulfill the liability, and reflects a bias in the estimate due to the entity’s perception of its indifference to variable and fixed cash flows.</p> <p>We question the appropriateness of the adaptation of the guidance from IFRS 13:</p> <p>The fair value guidance in IFRS 13 (contained in Appendix A to the illustrative ED) requires a risk adjustment because market participants would require compensation for the uncertainty inherent in the future cash flows.</p> <p>The proposed guidance in paragraphs B14 and B15 related to a risk premium for fulfillment value requires the use of market-based assumptions that may not be relevant to a public sector entity.</p> <p>We also question the appropriateness of the adaptation of the guidance from IFRS 17 Insurance Contracts:</p> <p>We note that some of the proposed text is drawn from IFRS 17 Insurance Contracts (IFRS 17, paragraphs B87, B90-92). However, IFRS 17 specifically requires the addition of a risk premium for non-financial risk, on the basis that financial risks are included in the estimation of the future cash flows or the discount rate.</p>
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Issue Number	Respondent	Issue
		<p>Conversely, paragraph B34 of the ED states that the risk adjustment should reflect all risks associated with the liability other than general operational risk.</p> <p>Consequently, it appears that financial risks would be double-counted by adding a risk premium to public sector liabilities measured at fulfillment value. As well, determination of whether there are other types of risks for which a risk premium could be relevant in the context of fulfillment value needs clarification.</p> <p>Consequently, we believe that more guidance and discussion is required on the appropriateness of adding a risk premium for liabilities measured at fulfillment value, and that criteria be developed for identifying public sector transactions where its inclusion in the measurement of the liability is relevant. As well, the use of market-based risk adjustments may not be appropriate and, therefore, guidance on establishing a risk adjustment that is relevant to public sector entities should be developed.</p>
FV 5	14	<p>22. Paragraph B18 explains how transaction costs are accounted for but we believe it would be more useful to have transaction costs as a specific heading in each of the measurement bases? Appendix D has done this (D27) but none of the other appendices have, so at a minimum there is a consistency issue that should be reviewed.</p> <p>23. We do not think the application of entity-specific values is well explained in paragraphs B14 and B15, in particular the relationship between market and entity based assumptions. For example, in paragraph B13, it states that the assumptions on the time value of money and risk premium are entity specific. Then paragraphs B14 and B15 say that the estimates should be market based and that the entity specific estimate should be the same as a market participant's estimate. B14 contains some typographical errors that need to be rectified.</p> <p>24. Paragraphs B13 to B15 refer to risk premiums that an entity needs to estimate and it may be helpful to signpost that further explanations and examples are provided in Appendix A.</p>
FV 6	15	<p>Most notably, we do not agree with the proposal to switch from cost of fulfilment to fulfilment value, as it is more than just a change in terminology. For example, the Illustrative ED proposes that fulfilment value should include a risk premium (also referred to as a risk adjustment). Although the IPSASB Conceptual Framework is silent on this matter, the Basis for Conclusions on IPSAS 42, Social Benefits states that cost of fulfilment does not include a risk adjustment. The appropriateness of including a risk margin for the liabilities of public sector entities has been the subject of much debate in New Zealand. This suggests that the new term fulfilment value being proposed is different to the extant term cost of fulfilment.</p>

Issue Number	Respondent	Issue
FV 7	19	<p>However, we consider that the link to IPSAS 19 Provision, Contingent Liabilities and Contingent Assets should be further explained. From our experience, fulfilment value is the measurement base that underpins the measured under IPSAS 19. The examples (legal claim and decommissioning liability) included in the illustrative ED seem to confirm that fact as they would fall in the scope of IPSAS 19.</p> <p>Paragraph B7 indicates that there are two layers in estimating the value of a liability: in a first step, an entity apply fulfilment value for the amount to fulfil the cost, and in a second step IPSAS 19 for the excess of the cost to fulfil.</p> <p>“The fulfilment value 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 fulfil the minimum obligation of restoring the land to its original condition and therefore are not representative of the cost to fulfil the liability. In cases where an entity intends to fulfil 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 fulfil.”</p> <p>The EC considers that IPSAS 19 would apply entirely to the examples provided in paragraph B4 and the best estimate of the expenditure required by IPSAS 19 would have to be applied in measuring the liability. This is particularly relevant since the proposed guidance for fulfilment value seems to overlap the guidance on measurement available in IPSAS 19, in particular due to the use of ‘least costly manner’ to settle the obligation, compared to the ‘most likely amount’ required by IPSAS 19 in computing the best estimate of the expenditure. Even though the current contradiction may already exist – since the ‘least costly manner’ is referred to in IPSAS CF, in practice IPSAS 19 requirements override the IPSAS CF in accordance with paragraph 9 of IPSAS 3. If the illustrative ED becomes an IPSAS, uncertainty will arise as to which standard should first be applied in terms of measurement of such liabilities.</p> <p>Consequently, we suggest that the IPSASB should clarify the interaction between the new guidance on fulfilment value and IPSAS 19.</p> <p>Moreover, in our view, it seems to be a contradiction between guidance in B9 and B10 (B11). While under B9 it is presumed that the least costly manner is the one in which the entity has selected to release itself from the obligation, B10 seems to indicate that this only applies when the entity would do the work by itself, while if this is contracted out – the least costly manner has to be proven.</p>

Issue Number	Respondent	Issue
FV 8	24	<p>Fulfilment value appears to mainly (or even solely) to liabilities and provisions. Given there is already an accounting standard on accounting for provisions, I do not see the point of moving the requirements to another standard.</p> <p>I found the changes very confusing, as I could not work out what was changing. I also believe there is a risk of changes that would result in differences to IFRS for no good reason. I believe fulfilment value is better left where it is. The IASB is currently conducting research as to what changes should be made to their standard given the change in their conceptual framework.</p> <p>The IASB undertook some proposed changes to the provisions standard in 2005 and 2010. I have not analysed whether any of the proposed changes, and the reasons for not proceeding with the changes, are relevant to this topic. From memory, there were issues with recognising a liability for the lower of fulfilling the liability by the entity compared to transferring to a third party.</p> <p>Other comments Paragraph 4.19 currently states: (b) For liabilities where the settlement amounts are uncertain and the timing is unknown</p> <p>The wording should be whether the amounts are uncertain or (emphasis added) timing is unknown.</p>
FV 9	25	<p>In addition, we note that IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets requires that liabilities should be measured at “best estimate” or present value. As a consequence, we would recommend that the IPSASB should elaborate on how cost of fulfilment would articulate with “best estimate”. We are wondering whether the proposed change is only to update the terminology and definition or if it might bring unintended consequences.</p>
FV 10	26	<p>I feel more guidance /discussion is required on Demolition & Disposal. When asset replacement occurs in the same exact location, then demolition and disposal of the previous asset is accounted for in the replacement cost of the new asset. An example would be renewal of road pavement where the existing asset is milled prior to placement of the new. These milling costs become part of the replacement cost of the new pavement.</p> <p>In many circumstances the replacement asset is located elsewhere, for example when a bridge is replaced, it is common to realign the road so construction can occur while the existing asset can continue to be used. Demolition and disposal of the existing road/bridge is generally not part of the replacement contract and not included as part of the replacement cost of the new asset. However, the liability for the demolition and disposal of the old asset remains. I presume that this would fall into this category of fulfilment value.</p> <p>From an intergenerational equity perspective, that liability should fall to the users of that facility, not the users of the new facility. Hence that fulfilment liability needs to be accounted for when the old asset is in use and not wait until the new asset is in use.</p> <p>Again, this may be an issue worth exploring as part of the IPSASB’s infrastructure assets project.</p>

Issue Number	Respondent	Issue
FV 11	28	<p>Appendix B is compiled from extracts from Chapter 7 of the IPSASB Conceptual Framework, with certain elaborations. In our opinion, the elaborations should be considered for inclusion in the Conceptual Framework, taking into consideration the following comments:</p> <p>a) There appears to be a conflict between B9 and B10 about the least costly manner of settlement.</p> <p>b) With reference to B12, as we already pointed out, sometimes a public sector entity cannot act “in its own economic best interest”; therefore, this assumption may need to be revised.</p> <p>c) B19 should refer to IPSAS 19 (similar to B7). d) The subjectivity required to calculate the Risk Adjustment (B32-B37) may have a negative impact on the level of accountability and may give misleading notions about the fulfilment value of a liability due by a public sector entity to a private third party.</p>
FV 12	31	<ul style="list-style-type: none"> • The definition includes an assumption that an entity will fulfill its obligations in the least costly manner. Does this assumption always make sense in the public sector? There may be policy reasons why an obligation may not be settled at the least costly amount. For example, regional development objectives may require that a costlier option be chosen. Similarly, paragraph B12. includes an assumption that the entity acts in its own economic best interest. Public sector choices may not always be in the economic best interest but may satisfy other policy objectives. We suggest the IPSASB discuss the description of fulfillment value in terms of public sector objectives to determine if the proposed definition and related text in Appendix B appropriately reflect the multiple objectives of public sector entities. • Consider if fulfillment value is a way to estimate the “historical cost” of a liability rather than a separate measurement basis. <ul style="list-style-type: none"> o The definition of fulfillment value in paragraph 6 of the illustrative ED implies that it is a cost-related attribute as follows: “Fulfillment value 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.” o We question if fulfilment value is a measurement basis as it includes an assumption. Should measurement bases include assumptions? Or do only valuation or estimation techniques require assumptions as inputs for measuring an item?

Supporting Documents 4 – Historical Cost (Unedited Responses)

Issue Number	Respondent	Issue
HC 1	04	<p>If the IPSASB decides to proceed with a general measurement standard (rather than developing an IPSAS that is equivalent to IFRS 13), we think the following two conditions could be used to identify application guidance that is appropriate for inclusion in a general measurement standard. The conditions are that the application guidance is:</p> <p>(a) public sector specific; and</p> <p>(b) sufficiently generic that it can be used in more than one standard.</p> <p>Application guidance on historical cost would not meet these conditions because there is little or no generic application guidance needed. We believe that much of the current application guidance on historical cost is best located in individual standards. In addition, moving guidance on historical costs from individual standards to a general measurement standard would result in unnecessary changes to IPSAS and potentially unnecessary differences between IPSAS and IFRS Standards.</p>
HC 2	04	<p>We note that the treatment of borrowing costs is an historical cost issue and that the discussion of historical cost should have included the borrowing cost discussion. Recent debates about which costs to include in the measurement of liabilities could also have been considered as part of a broader historical cost discussion.</p>
HC 3	04	<p>We disagree with the IPSASB’s assertion that historical cost is not applicable to liabilities (as per the footnote 38 to Appendix C, shown below). Historical cost is a possible measurement basis for liabilities, with some liabilities being measured at amortised cost. As noted in an AASB occasional paper (2013), many liabilities do not have historical proceeds but, if the amounts of the proceeds attributable to a liability are clearly evident and the amount reflects the characteristics of the liability, historical cost could be a reasonable surrogate for exit-price or entity-specific value. The assertion that historical cost is not applicable to liabilities also seems inconsistent with Diagram 4.2 Subsequent Measurement: Liabilities which suggests that the IPSASB will consider historical cost as a measurement basis for liabilities.</p> <p>This application guidance focuses on historical cost for assets, because the consultation paper’s flow chart for liability measurement indicates that historical cost is not applicable to the measurement of liabilities. It does not address depreciation, amortization and impairment, because previous IPSASB decisions have indicated that these should be addressed in other IPSAS, rather than IPSAS, Measurement.</p>

<p>HC 4</p>	<p>07</p>	<p>Paragraph C1 - Consider amending as follows: "...at the time of its acquisition and/or development..." so that it is clear that an asset could be both acquired and subsequently developed (this proposed amendment is also consistent with wording in paragraph C11).</p> <p>Also consider changing the tenses of 'develop' or 'acquire' to past tense, i.e. 'developed' or 'acquired'.</p> <p>Paragraph C4 – Reference is made to a 'current value'. It is unclear what this 'current value' represents and how it would be calculated.</p> <p>Footnote 38 - "The application guidance focuses on historical cost for assets, because the consultation paper's flow chart for liability indicates that historical cost is not applicable to the measurement of liabilities." Page 41 of the Consultation Paper however seems to refer specifically to historical cost. This footnote seems to be inconsistent with the flow chart in the Consultation Paper.</p> <p>Paragraph C8 - Review the drafting of the last sentence as some wording seems to be missing.</p> <p>Paragraph C10 - An example of a bond is used in this paragraph. As bonds are initially measured at fair value at acquisition, this example seems inappropriate in a discussion of amortised cost.</p> <p>Paragraph C15(b)(v) - The IASB is proposing changes to whether these proceeds can be included in the cost of the assets. The IPSASB should monitor the project to ensure that the latest developments</p> <p>PV3.2 We question the interaction between the guidance in the illustrative Exposure Draft and the existing IPSAS on Intangible Assets. Paragraph C18 specifically refers to intangible assets and the treatment of development costs. We question if this is consistent with the idea that the IPSAS on Measurement would deal with generic principles and the specific treatment of transactions in the individual IPSAS.</p> <p>PV3.3 We question the guidance in paragraphs C7 to C19. It seems to be written as a 'guidance manual' rather than clearly articulating principles for when costs are capitalised to the cost of an asset or not. In particular, the discussions on the capitalisation of costs based on how an asset is acquired seems to provide guidance rather than clear principles that could be applied to a range of scenarios. Only the text that clearly articulates a principle should be retained.</p> <p>PV3.4 We question the need for amortised cost in the 'historical cost' chapter. While we appreciate that there is a view that amortised cost may depict a cost measure, it is not defined in the same way as 'historical cost' in the definitions section of the illustrative Exposure Draft and paragraph C1. The paragraphs – which are drawn from the IASB's Conceptual Framework – are too generic to be of any value in an IPSAS outlining the detailed application of the measurement bases.</p> <p>PV3.5 Some stakeholders questioned whether amortised cost is always a historical measure. If amortised cost is calculated on a variable rate instrument where the rate resets to a market rate at specified intervals, the amortised cost may be closer to a 'current' measure.</p>
<p>HC 5</p>	<p>13</p>	<p>We believe that improvements are needed on the following issues.</p>

Issue Number	Respondent	Issue
		<p>1. Paragraphs C12 to C13 and C15 to C17 all address the issues of incidental costs. A single requirement for them should be developed. C12(b), for example, refers to specific examples related to costs incidental to purchase. C15 includes an example of the costs that should be included in consideration attributable to purchase and/or development (that is, incidental costs). The descriptions are redundant.</p> <p>2. C16 states that costs are excluded from the consideration (they are not incidental costs) if they: (a) are not directly incidental to the asset's acquisition and/or development; or (b) do not contribute to the ability to create the asset's service potential and/or future economic benefits. This may imply that an incidental cost can be excluded only if condition (b) is met. The reference to (a) should be retained, but (b) only relates to the introduction of examples. Condition (b), accordingly, is not a criterion independently applicable, and should be moved to C17. Thus, C16 should thus be revised as follows:</p> <p>C16. Costs not directly incidental to the asset's acquisition and/or development are excluded from the consideration that forms a part of an asset's historical cost.</p>
HC 6	14	<p>We note that paragraph C13 is derived from IASB's CF BC6.32 and BC6.33. Given that C13 is only part of an illustrative ED, we will not propose drafting changes in this response but instead voice our concerns that IASB's Basis for Conclusions have been turned into an integral part the illustrative ED. Basis for Conclusions are not integral to standards and IPSASB should be referring to the core body of IASB's literature for use in their standards.</p>

Issue Number	Respondent	Issue
HC 7	15	<p>However, we have some observations on its appropriateness in the context of these proposals. It appears that the appendices contain:</p> <ul style="list-style-type: none"> • Content taken from the Conceptual Frameworks (IPSASB and IASB); • Content taken from other IPSAS; and • Newly added content. <p>Due to its very nature, the content taken from the Conceptual Frameworks is not helpful as application guidance. It repeats extant content without adding practical guidance. The content taken from other IPSAS is also generally not helpful when taken from the ‘body’ of extant IPSAS which contain principles and requirements rather than ‘application guidance.’ As mentioned in our response to the IPSASB’s preliminary view 2 above, various aspects of guidance often occur only once throughout IPSAS. Therefore, we question whether it is appropriate to consider such guidance generic. Arguably, the newly added content is not helpful as application guidance either – as it appears to be conceptual, and we have the following reservations:</p> <ul style="list-style-type: none"> • We are unsure what the gaps in IPSAS are that the IPSASB is attempting to address. Specific concerns in the public sector have not been highlighted suggesting the need for solutions proposed in the Illustrative ED paragraph C12 in the Appendix C to the Illustrative ED refers to transport costs incurred in relation to consideration for a purchased asset. Whilst transport costs may be relevant to the purchase of a non-financial asset, it is unlikely to be relevant to the acquisition of a financial instrument.

<p>HC 8</p>	<p>19</p>	<p>The value of Other Consideration: Exchange for Non-Monetary Asset(s)</p> <p>Currently, paragraph 38 of IPSAS 17 Property, Plant and Equipment requires an entity to measure an exchanged asset at fair value (unless it lacks commercial substance; or the fair value of either the asset given or asset received is not reliably estimate). The standard further clarifies in paragraph 40 that if an entity is able to determine reliably the fair value of both (asset given up/received), then the fair value of the asset given up shall be used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.</p> <p>We understand that paragraph C4 of the illustrative ED the IPSASB provides two changes in substance to the above:</p> <ul style="list-style-type: none"> - Fair value is replaced by current value: The EC considers that using the current value might be more appropriate in public sector as preparers are allowed to choose the appropriate current value dependent on the economic circumstances and the objectives of financial reporting (i.e. cost of services, operational capacity and financial capacity). - Fair value of the asset received: We noticed that in paragraph C4 of the illustrative ED, the condition (b) (the current fair value of the asset given up cannot be measured (...)) was also changed as compared to the current wording of IPSAS 17 given that the standard refers to the fair value of the asset given up or received. We suggest clarifying whether or not this change was intended and the reasons for it. It would in particular be useful to understand how entities should apply the guidance to an exchange of assets, since the reading of the new text seems inconsistent with the provisions in IPSAS 17, which currently requires that the value of the asset received should be used if more clearly evident. Finally, we note that the same requirement exists for intangible assets (IPSAS 31.44), to the extent that IPSAS 17 is amended, IPSAS 31 Intangible Assets should be amended accordingly. <p>Furthermore, we highlight that there might be an inconsistency between the measurement of an asset acquired in an exchange of asset that lacks commercial substance, which shall be measured at carrying amount, and an asset acquired in a non-exchange transaction that falls in the scope of IPSAS 23 Revenue From Non-Exchange Transactions (Taxes and Transfer), which requires the asset to be measured at fair value at initial recognition.</p> <p>Purchase, Construction and Development of an Asset: Examples of Consideration to Include</p> <p>The illustrative exposure draft includes in paragraph C15 guidance drawn from IPSAS 17 on the elements of the cost. We would like to suggest including guidance on the following issues:</p> <p>(i) Penalties: consider clarifying whether any penalties (liquidated damages) received should be deducted from the cost of the item in case a constructor would have to compensate the entity for delays in the asset development; and</p> <p>(ii) Incentives: consider clarifying whether the cost of the item should include any contractual amount conditional to a future event (e.g. the construction contract may include incentives that are only to be paid depending on the quality of the asset functioning during several years of operations).</p>
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Issue Number	Respondent	Issue
		<p>Finally, in reference to C18, we would propose to reconsider if some of the guidance included in IPSAS 31 should become part of the generic guidance on the historic costs in the future measurement standard. We note that there could be cases where a development of a PPE item is also preceded by a research phase. In particular, we refer to feasibility studies done for some innovative, specialised assets (e.g. satellite navigation systems).</p>
HC 9	20	<p>In developing measurement guidance for historical cost in the Illustrative ED, the IPSASB consolidated guidance available in the Conceptual Framework, IPSAS 16 (Investment Property), and IPSAS 17 (Property, Plant, and Equipment), but the board did not address historical cost for liabilities.</p>
HC 10	24	<p>Historical cost has been used for many years. Moving it to one area and changing those requirements to make it consistent is then going to change how those items are accounted for. Or at a minimum, raising questions as to whether there has been a change.</p> <p>Given the desire to be consistent with IFRS, I believe the changes to historical cost should not be made, and the requirements (even if inconsistent) left as they are.</p> <p>I have encountered diversity in the accounting treatment of long-term prepayments, say 10 to 20 years, and some for 99 years. I have included details in Appendix 1. I request the IPSASB to provide some guidance on this issue.</p>
HC 11	24	<p>Other comments Paragraph C15 – Currently deducts proceeds from testing. The IASB project needs to be monitored. https://www.ifrs.org/projects/work-plan/property-plant-and-equipmentproceeds-before-intended-use/</p> <p>Paragraph C21 does not look right. It currently states: 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.</p> <p>The paragraph appears to be drafted to pick up the essentially practical expedient for floating rate notes in IFRS 9. However, the reference to ‘variable rate’ might also pick up instruments that have different rates for different periods, e.g. 3% for the first two years, and 5% in years 4 and 5 – in this situation the effective interest rate method covers this.</p>
HC 12	28	<p>The guidance in Appendix C should be extended to also apply to liabilities because short-term payables (example, most trade payables) may be measured at the original invoice amount if the effect of discounting is not material. Furthermore, with respect to fulfilment of liabilities, B20 (Page 75) states that “an entity need not discount the value of the future outflow of resources if the entity expects the obligation to be settled within one year”. Historical cost is acceptable for measuring short-term liabilities. Longer term debts and similar obligations would represent more difficult measurement issues.</p>

Issue Number	Respondent	Issue
HC 13	31	<p>We have the following comments on Appendix C:</p> <ul style="list-style-type: none">• Footnote 38 on the heading of the Appendix indicates the guidance focuses on the historical cost of assets because the consultation paper’s flow chart for liability measurement indicates that historical cost is not applicable to the measurement of liabilities. We disagree with this statement for the following reasons:<ul style="list-style-type: none">- According to the Liability Flow Chart in Diagram 4.2, historical cost is one of the options.- Historical cost, as a measurement attribute has been used for liabilities.- Your conceptual framework lists historical cost for liabilities.- The IASB, in its conceptual framework, also acknowledges “historical cost” as a measurement base for liabilities.- The equivalent to historical cost for liabilities is “historical proceeds”.

Issue Number	Respondent	Issue
HC 14	31	<ul style="list-style-type: none"> • There is no discussion as to what happens to the historical cost value subsequent to initial measurement in the Appendix (some information is included in the body of the illustrative exposure draft). It may be helpful to include this information. An example of this information could be “Subsequent to initial measurement: <ul style="list-style-type: none"> (a) the historical cost of an asset may be adjusted (e.g., for amortization or impairment); or (b) the historical cost of a liability may be adjusted (e.g., to reflect the accrual of interest, the accretion of a discount or amortization of a premium); or (c) an estimated historical cost amount may be adjusted because of a change in an estimate.” • The phrase “acquire, construct and/or develop” is introduced as a heading to paragraph C10 and then used for the remainder of the Appendix. To be consistent in the Appendix, it may be helpful to include the phrase from the start (i.e. at the start of the appendix, the phrase “to acquire or develop” is used). • The Appendix has a section on costs incurred after the acquisition and/or development of the asset that should be excluded. It may be helpful to include guidance as to costs that could be included such as betterments. • Appendix A, B and D start with the objective of the specific measurement base. It may be helpful to include this objective in Appendix C to be consistent with the other Appendices. • It may be appropriate to indicate that historical cost/historical proceeds may be a known amount, because of a transaction/contract price. Or, historical cost may be an estimated amount. For example: <ul style="list-style-type: none"> o An estimate of a government’s liability for recovery assistance may be required for an event such as a natural disaster (this may mean that “fulfillment value” is a way to estimate the historical amount of a liability). o An estimate may also be required for an inherited asset initially accounted for, and for which no historical cost is available. The fair value ascribed to the asset at initial measurement² may be one way to estimate its historical cost, or valuation techniques may be required for such estimation.

Supporting Documents 5 – Replacement Cost (Unedited Responses)

Issue Number	Respondent	Issue
RC 1	04	<p>If the IPSASB proceeds to issue application guidance on fair value, it will need to decide how to clearly differentiate between the use of the cost approach to determine fair value and replacement cost as a separate measurement basis. There is a risk of constituents being confused about the use of replacement cost in two contexts. Appendix A (paragraph A39) refers to current replacement cost in the discussion of the cost approach to determining fair value and Appendix D is about replacement cost as a measurement basis in its own right. Although these two terms are very similar they are talking about quite different measures. The cost approach in Appendix A has a different measurement objective to replacement cost as a measurement basis. Different terminology might be one way of avoiding confusion. The IPSASB will also need to clearly indicate in standards when they are referring to replacement cost as a separate measurement basis.</p> <p>In both cases an entity would be using cost information to arrive at a measure for financial reporting, but the measurement objective would determine what costs should be included. IFRS 13 has a specific measurement objective – it discusses the use of the cost approach as a method to estimate fair value as defined in IFRS 13 (which is from the perspective of a market participant seller). Moreover, IFRS 13 is focused on the price that a market participant would be willing to pay to acquire the cash-generating-capacity of the asset, rather than its potential to provide public services (i.e. its service potential).</p> <p>In summary, in order to apply the measurement requirements in IPSAS, constituents will need to know whether the measure is an entry or exit measure and whether it is intended to be entity specific or have a market participant focus. They also need to know whether to focus solely on an asset’s potential to generate cash flows or whether to consider an asset’s service potential. The distinction between assets held mainly for cash generation and assets held mainly for service potential may be one way of determining when the cost approach (as a method of estimating fair value) versus replacement cost (as a distinct and different measurement basis) are appropriate.</p>

Issue Number	Respondent	Issue
RC 2	04	<p>Comments on using DRC to estimate fair value (as currently defined in IPSAS)</p> <p>IPSAS 17 permits the use of depreciated replacement cost as a means of estimating the fair value of an asset. When the NZASB introduced PBE IPSAS 17 Property, Plant and Equipment it noted that public benefit entities in New Zealand frequently use depreciated replacement cost to estimate the fair value of property, plant and equipment, including infrastructure assets. The NZASB noted that neither IPSAS 17 nor IPSAS 21 Impairment of Non-Cash-Generating Assets provide guidance on this topic at the level of detail previously provided in NZ IAS 16 Property, Plant and Equipment. The NZASB included additional application guidance on this topic in order to enhance the consistency of asset valuations in financial statements. That guidance addressed specific issues that had arisen in practice.</p> <p>In our view the application guidance that accompanies PBE IPSAS 17 more clearly addresses some of these issues than the proposed guidance in Appendix D. For example, Appendix D doesn't appear to cover the situation where the entity has to do extensive work to get land into a condition suitable for use and that use is specialised. We also note that paragraph D5 refers to "the current value of the existing site" but it isn't clear whether this is (i) the value of the current site, based on the current use or (ii) the highest and best use of that site. The additional guidance in PBE IPSAS 17 drew upon international valuation guidance available when PBE IPSAS 17 was developed.</p> <p>In the interests of developing guidance that works internationally and is consistent with the international valuation standards, we encourage the IPSASB to continue to work with the International Valuation Standards Council.</p>
RC 3	04	<p>The CP proposes to adopt much of the guidance in IFRS 13, including the guidance dealing with the use of the cost approach (also referred to as current replacement cost) as a valuation technique to estimate fair value. It also proposes to provide guidance on replacement cost as a separate measurement basis. If the IPSASB decides that fair value, as defined in IFRS 13, should be acknowledged as a measurement basis appropriate for IPSAS and supported by application guidance, the IPSASB will need to give more detailed consideration to a number of matters. It will need to differentiate between the use of the cost approach under fair value and replacement cost as a separate measurement basis, outline its views on when each would be appropriate and indicate how it intends to give effect to these views in standards, particularly in relation to the revaluation model in IPSAS 17 Property, Plant and Equipment. The CP (paragraph 2.17) does acknowledge that the IPSASB needs to further develop the relationship between replacement cost as a measurement basis and replacement cost as a measurement technique. We believe this work should have been done first and needs to be done before any guidance is finalised</p>

RC 4	06	<p>D5 Location Factors: We believe that this does not adequately explain the approach to be adopted where public services need to be situated in expensive city centre locations and where the value of land, at least superficially, for alternative uses is much higher. When it is stated that the replacement cost of the land is based on the current value of the existing site, does this mean its value for the current use or the current value for an alternative use that would be permitted if the hospital, school etc was not required in this location?</p> <p>Other factors that need exploration in application guidance is the role of any legislation controlling land use, which may have designated city centre land specially for public service uses. This would mean that the highest and best use would be for the designated public service use, not for any alternative higher value uses that may surround it. In other cases, a public service use may not be on a site which has specific legal limitation to that use, perhaps because the use is historic. What assumptions should be made about the cost of acquiring a site for the public service use in that locality under these circumstances?</p> <p>We would submit that, while information about the potential for higher value uses may be material to a public entity for planning and efficient location of future projects, for measuring the value of an existing asset for financial reporting it has little relevance, especially if it means that the value of the land is incompatible with the continuing provision of the public service. An entity needing to replace the remaining service potential would not rationally buy land that had a value for an alternative use in excess of that that could be supported for the existing use.</p> <p>We understand and support the use of the concept of “Replacement Cost” where Fair Value or Historic Cost do not best meet the measurement objective. However, the term “Replacement Cost” fails to convey that this is a current value measure and is too easily confused with an actual cost or the cost of replacing or reinstating if the asset were lost by fire or another hazard.</p> <p>In the UK, the government and other public sector bodies have adopted accounting principles largely based on IFRS but for property owned and occupied for service delivery do not use IFRS Fair Value but an alternative, “Existing Use Value”. This was originally developed in the 1990s by the RICS working in conjunction with the former UK Accounting Standards Board for application to owner occupied property in the private sector, although this did not survive the requirement for all listed private entities to adopt IFRS in 2005. However, the public sector clearly considered it was a useful alternative taking into account the problems of applying Fair Value to many types of land and buildings held to deliver a service.</p> <p>Existing Use Value (EUV) meets the broad criteria of Replacement Cost as defined in the Illustrative ED but is more precisely defined as: “The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm’s-length transaction, after proper marketing wherein the parties had acted knowledgeably, prudently and without compulsion, assuming that the buyer is granted vacant possession of all parts of the property required by the business and disregarding potential alternative uses and any other characteristics of the property that would cause its Market Value to differ from that needed to replace the remaining service potential at least cost.”</p> <p>It will be noted that the first half of this EUV definition is the same as the IVSC definition of market value, but there are four additional conditions in the italicised section. Examination of these help to understand how EUV differs from Market Value: “ ... assuming that the buyer is granted vacant possession ...”. This means that in the hypothetical exchange physical and legal possession passes to the buyer of all parts of the</p>
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Issue Number	Respondent	Issue
		<p>property required to provide the service. In the case of property this does not mean that any building is assumed to be disused or empty with all that could imply in terms of additional costs for either party. If any part of a property is occupied by a third party, the valuation will reflect the benefit or encumbrance of those occupations. "...of all parts of the property required by the business...". This reinforces the objective for the value to reflect the potential for the asset to provide the service required of it by the reporting entity. The reference to "the business" reflects the definition's origins but has been accepted by the UK Government and public sector as also meaning "... of all parts of the property required for delivery of the service..". If parts of a property are surplus to the operational requirements and if they are capable of separate occupation then they should be categorised as surplus, and separately valued. Any surplus parts incapable of separate occupation would be expected to have no more than a nominal EUV, as they would contribute nothing to the service potential of the property and would not feature in a replacement at least cost. "...disregarding potential alternative uses...". Unlike market value, which is unconcerned with the needs of a specific entity, EUV requires the valuer to disregard uses that would drive the value above that needed to replace the service potential of the property to the reporting entity. A public sector entity will often have a statutory duty to provide a service in a particular locality and, therefore, potentially higher value uses are of no relevance unless and until the property becomes surplus. Notwithstanding, it would be appropriate to take into account the potential for additional development of a property providing this was for the existing use, would be required by the entity and that such construction could be undertaken without major interruption to the current operation. "...disregarding any other characteristics of the property that would cause the market value to differ from that needed to replace the remaining service potential at least cost.". This is a "catch all" instruction to ignore any factor that would be reflected in the market value but that is irrelevant to the continued provision of the service. Examples include restrictive user covenants, planning conditions or remedial costs that would be incurred if the existing use ceased. Another would be where a property is in an unusual location or is oversized for its location which would restrict its market value below the cost of replacing the service potential.</p> <p>Like other bases of value, EUV can be estimated using any of the main valuation techniques, i.e. the market approach, the cost approach and the income approach.</p> <p>We are also aware that EUV is being considered as a suitable alternative to Fair Value in other jurisdictions where an objective measure of the cost of replacing the service potential is considered more relevant and capable of estimation than the amount that could be obtained on disposal. Given that EUV has had the benefit of some twenty five years' use, over which time it has been refined and a body of guidance developed around it, we believe that it is worth the Board considering this as an alternative to "Replacement Cost".</p> <p>This would also have the advantage of avoiding confusion with historic cost which is available as a measurement option but for which the techniques used for any of the three valuation options have no relevance.</p>

Issue Number	Respondent	Issue
RC 5	07	<p>Replacement cost as a measurement basis and an approach to determine fair value</p> <ul style="list-style-type: none"> • At present, 'replacement cost' is identified as a measurement basis in the Conceptual Framework and the illustrative Exposure Draft. 'Replacement cost' is also the basis used when applying the 'cost approach' in determining fair value in IFRS 13. • We do not believe that replacement cost can be used as a measurement basis and as a measurement approach means of calculating fair value. • The 'cost approach' in IFRS 13 (which is measured using replacement cost) is most commonly used in measuring non-monetary assets such as infrastructure. These assets are likely to be held for their operational capacity rather than their financial capacity. In line with our proposal above, we are of the view that fair value should only be used to measure financial capacity. As a result, it may not be necessary to include the 'cost approach' in the fair value guidance. We suggest removing the 'cost approach' from fair value. <p>PV6.2 One of the methods used to determine fair value is the 'cost approach' which is based on the 'current replacement cost' of the asset. We have two concerns about this:</p> <p>(a) It is unclear whether the 'current replacement cost' in IFRS 13 is the same as the 'replacement cost' in Appendix D. While there are similarities in their definitions, different wording is used to describe the same concepts, and the treatment of disposal proceeds at the end of an asset's life is unclear.</p> <p>(b) If 'current replacement cost' and 'replacement cost' are the same and are calculated on the same basis, it is untenable to have the same measurement basis being used as a measurement basis in its own right (Appendix D) as well as a way of determining another (i.e. fair value in Appendix A).</p>

Issue Number	Respondent	Issue
RC 6	07	<p>PV6.3 We have the following comments on the text included in Appendix D:</p> <p>The guidance in paragraphs D7 to D10 deals with the separation of assets into separate components to determine their useful lives. The separation of assets into components and identifying their useful lives is not unique to the replacement cost measurement basis. In accordance with the IPSAS on Property, Plant and Equipment (IPSAS 17), the components of assets and their useful lives should be determined irrespective of whether the historical cost or revaluation method is applied. We therefore suggest removing this section from the replacement cost chapter and it being retained in IPSAS 17.</p> <p>Paragraph D8 makes reference to "...an entity should have regard to the materiality of the assets in relation to the statement of financial position and also think carefully about what is significant...". The difference between significance and materiality is an area that causes confusion among preparers. These two terms are used here generically and do not provide preparers with any assistance. Components of assets are considered in relation to the cost of an asset – not to the value of assets on the statement of financial position. Guidance should be provided about how significance should be assessed. Given that more explicit guidance is provided in IPSAS 17, we suggest that this discussion should be located in IPSAS 17 rather than in the IPSAS on Measurement.</p> <p>Paragraph D35 - The service units approach seems better suited (as drafted) for an impairment test. Consider whether this measurement technique is needed in this chapter.</p> <p>Paragraph D1 and D2 - The different use of the term 'reporting date' and 'measurement date' is observed.</p> <p>Paragraph D7 - The reference to 'design lives' should be changed to 'economic lives'. Design life is a term generally used by engineers and is often inconsistent with the idea of economic life for accounting purposes. Engineers will not change or extend the 'design life' of an asset, but for accounting purposes the actual use of an asset by all users (i.e. economic life) may extend beyond an asset's design life.</p> <p>Paragraph D16 - This paragraph should make it clear that even though land is included in the valuation, it should be accounted for separately in accordance with the relevant IPSAS.</p> <p>Paragraph D21 - Reference is made to 'listed' assets. It is unclear what this means.</p> <p>Paragraph D36 - Reference is made to "date of valuation" – consider amending as suggested.</p> <p>Paragraph D38: The reference to borrowing costs be deleted.</p>

Issue Number	Respondent	Issue
RC7	15	<p>Australia and New Zealand look to IPSAS when developing accounting standards for both the public sector and private not-for-profit sector. Often there are no market participants in these sectors, and therefore trying to come up with a hypothetical market participant when there is not one causes issues. We believe that there is insufficient guidance currently for replacement cost, as there are further issues over and above the hypothetical market participant problem. Some of the issues the public sector is currently facing in applying replacement cost include:</p> <ul style="list-style-type: none"> - determining the unit of account when valuing assets (e.g. to what extent should land and non-land assets be disaggregated for the purpose of selecting the appropriate valuation stream), - considering the impact of legal and physical restrictions on current replacement cost, - deciding which costs to include in the replacement cost (especially in situations where part of an asset rather than the entire asset is replaced), - determining economic obsolescence and temporary overcapacity, and - when using current replacement cost, adjusting for differences in utility between existing assets and the modern equivalent. <p>Specific issues such as those listed above have not been addressed in the Consultation Paper, and in this regard, we encourage the IPSASB to reach out to the AASB and the New Zealand Accounting Standards Board (NZASB).</p>
RC8	16	<p>In our view, more specific application guidance on replacement cost should be provided, especially how to determine replacement cost in the case of specialized asset/infrastructure assets in the public sector. With regards to the definitions in the ED, we suggest to use the term “current replacement cost approach” rather than “cost approach” to avoid mixing that up with the cost model used in IPSAS 16/17/31. We consider Appendix D: Replacement Cost–Application Guidance, to be complete.</p>
RC9	20	<p>However, as mentioned in the answer about PV4, we believe that it is important to describe the relationship between replacement cost as defined in the Conceptual Framework (as a measurement basis) and replacement cost as a measurement technique to determine fair value.</p>
RC10	24	<p>Distinguishing between replacement cost as a measurement base and replacement cost as a method of determining fair value.</p>

Issue Number	Respondent	Issue
RC11	24	<p>I agree with the use of replacement cost as a measurement base for PPE. While we often use a form of replacement cost in determining level 3 fair values for infrastructure assets, we have to deal with exit value concepts such as the nonexistent hypothetical market participant issue discussed above. The Consultation Paper’s approach would mean not having to deal with issue, and using entity specific assumptions.</p> <p>More guidance is required in how to apply replacement cost. I have included in Appendix 2 a list of numerous practical issues I have encountered in applying IFRS 13 in the public sector, particularly to infrastructure assets. These issues will need to be addressed if replacement cost is used for many of those assets.</p> <p>Other comments Paragraph D4 - Alternate locations – I do not agree with the guidance about having to identify alternate locations. Having to assess possible alternate locations is not useful if there are no plans to move the asset. Having to spend time on this issue is similar to the non-existent hypothetical market participant concept. These paragraphs are inconsistent with paragraphs D25 and D26.</p> <p>I support the approach of paragraphs D25 and D26 not requiring unnecessary time and expense on hypotheticals.</p> <p>Paragraph D12 – More guidance is needed on valuing the school as a 100 student school – do you value the gross replacement cost being for the asset that is there being a 500 student school and then adjusting for economic obsolescence to reduce the net replacement cost for a 100 student school, or do you just do one valuation and the gross replacement cost is based on a 100 student school.</p> <p>Paragraph D22 – Restrictions. Australia is currently addressing issues relating to restrictions, particularly on land under public sector assets, including land under roads and land under schools. Some jurisdictions arbitrarily apply discounts because of the public sector usage, and other jurisdictions do not.</p> <p>Paragraph D33 – the reference to a 300 student school is different to the earlier example of a 100 student school. Also refer to earlier comments on paragraph D12.</p> <p>Paragraph D37 – Site preparation. This paragraph is confusing and appears to require the day 2 write-off of site preparation and earthwork costs by not including them in the replacement costs.</p>

Issue Number	Respondent	Issue
RC 12	25	<p>We observe that replacement cost is used in several occasions in the suite of IPSAS standards, for instance as follows:</p> <ul style="list-style-type: none"> - In IPSAS 12, current replacement cost is defined as “the cost the entity would incur to acquire the asset on the reporting date” (See IPSAS 12.9. 7); - IPSAS 17.8 refers to depreciated replacement cost as an estimation of fair value in the case of specialised buildings measured using the revaluation model. Incidentally, the question of the distinction between a measurement model and a measurement basis could also be raised here; - IPSAS 21.9 also uses a reference to depreciated replacement cost, though more as an approach, to measure “the present value of the remaining service potential of an asset.”; - In the Conceptual Framework, it is further described as a surrogate for value in use in those cases where expected cash flows are inappropriate. <p>Based on the above observation, replacement cost could be perceived as a subset of fair value. We would therefore question whether it is relevant to discuss replacement cost in a standalone appendix. In that line of thoughts, we note that IFRS 13.11 refers to replacement cost as a valuation technique to measure fair value. Conversely, the decision tree in diagram 4.1 indicates that replacement cost is to be selected for assets that are held for their operational capacities; hence, replacement cost is considered different from fair value that would be selected for assets that are held for their financial capacities. We would therefore recommend that the IPSAS Board decide whether replacement cost should be related to fair value; if it should, we would be grateful that the Board elaborate on the consequences, especially with respect to the decision trees. We believe that it is critical to resolve that perceived inconsistency before an opinion can be formed on the merits of Appendix D.</p> <p>Another issue that arises from the above finding is that, should replacement cost be considered a fair value-type of measurement, then one could argue that the distinction between operational and financial capacities is somehow conceptually flawed and practically not helpful. We would appreciate if the IPSAS Board could tackle this additional concern.</p>

<p>RC 13</p>	<p>26</p>	<p>Section D30 - Depreciated Replacement Cost</p> <p>Replacement cost is defined as the cost to replace the service potential of an asset. In other words, the entry cost or cost to construct. The cost-based value at any time during its lifecycle is given by the replacement cost less deductions for depreciation. This is called the depreciated replacement cost. The depreciation for infrastructure assets is invariably straight line and represents an accounting allocation of the depreciable costs over the life of the asset. Unfortunately, the accounting depreciated replacement cost can be significantly different from the entry value of an asset except when the asset is brand new.</p> <p>I will demonstrate this with a simple example. Take a specialised asset, a bridge. It has a construction cost of \$10M and is 35 years old. The average total life for such a structure is say 80 years and therefore has an expected remaining life of 45 years. The DRC of the bridge is $\\$10M \times 45/80 = \\$5.625M$. The entry cost for purchasing the 35 year old bridge should take into account the expected timing of expenditures rather than the cumulative accounting depreciation. In this instance the value is the cost of a new bridge less the difference in present value cost of bringing forward the purchase of a replacement from 80 years time to 45 years time. Assuming a net discount rate of 4%, the entry cost of the 35 year old bridge is $\\$RC0 + 0.043 = \\$8.7M$. The two values are significantly different.</p> <p>The entry value for someone purchasing the asset partway through its lifecycle is best represented by its economic value, not depreciated replacement cost. What I am proposing here is an alternative measure of fair value for a specialised asset.</p> <p>Section D38 – Phasing of Work</p> <p>This section states that the value of a modern equivalent asset that had been developed in phases, should assume that construction happened instantly. I do not agree with this statement. When it comes to constructing say a passenger terminal at an airport, the terminal is generally constructed in phases as demand grows. Optimisation is all about minimising the full lifecycle costs. Constructing the full sized terminal at year zero would have a lower construction cost because it is built in a greenfield situation whereas the increments have a much higher cost because construction occurs in a brownfield situation. Yet the present value cost of incrementally extending the building to match passenger growth over time will likely be lower than the upfront cost of a single phase building. Requiring an incrementally grown asset to be valued as a single point build, would result in a significant writedown in the value of capital spend each time a new increment is added.</p> <p>This section also states that no allowance should be made for holding cost (the cost of capital over the duration of construction). This is because construction is assumed to occur instantaneously. This is an unrealistic requirement. Holding costs are real and occur in all efficient construction markets.</p> <p>Section D40 – Contract Variations</p> <p>This section states that additional construction costs because of design or specification changes should be ignored. This does not seem right. Those changes are most probably made to improve the asset level</p>
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<p>RC 14</p>	<p>27</p>	<p>D3 & D13</p> <p>We believe D3 and D13 are erroneous due to ‘condition’ and ‘asset specification’ being included in the wrong paragraphs. Under the standard we first need to determine the Replacement Cost and then based on relevant factors assess the remaining service potential to determine the Depreciated Replacement Cost.</p> <p>The ‘condition’ of the asset is relevant to the determination of the ‘Depreciated Replacement Cost’ and not the ‘Replacement Cost’. Likewise the ‘specification’ of the asset is relevant to the determination of the ‘Replacement Cost’ not the ‘DRC’. I.e. Two identical assets used in the same way will have the same replacement cost irrespective of their condition. If one is a far worse condition than the other the Depreciated Replacement Cost would be expected to be lower.</p> <p>The ‘condition’ of the asset should be moved to D13 and the ‘specification’ of the asset should be moved from D13 to D3.</p> <p>D12</p> <p>Agree with the comment. However, believe additional comment needs to be added to clarify that if the decrease in capacity is expected to be temporary (i.e. school numbers are expected to be 500 again in 10 year) that the replacement cost should be determined based on 500 students.</p> <p>D22</p> <p>We agree with the comment however believe that this paragraph is either not required or needs to be enhanced to ensure there is no ambiguity. i.e. Confirm that the value is the full un-discounted cost of its replacement cost.</p> <p>For many this paragraph will convey a belief that because the land is used as parkland that the value needs to be discounted from a market value of what it would cost the government to purchase the land.</p> <p>This issue was recently considered by the AASB which concluded that the value of such land should be based on its replacement value and as the government would need to pay a full market price to obtain such land the replacement cost is the amount paid.</p> <p>Under the proposed IPSASB framework such land would also be valued using DRC as it is held on an on-going basis, not held at historical cost and is specialized in nature as it is restricted for specific use and is not land held in freehold title.</p> <p>Under both IFRS and IPSAS restricted land such as parkland should be valued at the full market rate that the government would need to pay in order for its acquisition.</p> <p>D30 Difference between depreciation expense and Depreciation for valuation</p>
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Issue Number	Respondent	Issue
		<p>While the standard highlights the need to adjust the replacement cost for the impact of obsolescence to determine the DRC it fails to highlight (as done in both IFRS and IVSC) standards that depreciation for financial reporting purposes (depreciation expense) is conceptual different from obsolescence (or depreciation) for valuation purposes.</p> <p>Especially for highly material infrastructure assets that experience regular renewal there is no link between depreciation expense and the asset value. The value needs to be based on the assessment of the various obsolescence types and in the case of physical obsolescence includes asset condition.</p> <p>We suggest paragraph D30 be enhanced to clarify that depreciation for financial reporting is conceptually different and not linked in any way to the assessment of the DRC.</p>
RC 15	29	<p>HoTARAC notes that paragraph 2.17 suggests further work is to be done on aligning the concept of replacement cost as measurement base and replacement cost as a measurement technique.</p>
RC 16	31	<p>IPSASB may want to consider providing guidance as to what is a “significant part” identified in paragraph D8.</p> <ul style="list-style-type: none"> • Paragraph D11 refers to service potential and service capacity. Are these terms intended to be used interchangeably? If so, it may be helpful to use one term, not both. If not, it may be helpful to define both terms. Note: PSAB uses “service capacity” in the same way that IPSASB employs “financial capacity” and “operational capacity”; that is, in a more global sense to measure the capacity of the entity to do something (in this case to serve the public). In contrast, “service potential” is used in relation to the capability of individual assets to be used to provide services. <p>Editorial Note: • In paragraph D6, consider if “D30-D32” should be replaced with “D31-D33”. • In paragraph D7, consider if “D30” should be replaced with “D31”.</p> <p>New Measurement Base: Reconstruction (or “reproduction”) cost may be a measurement basis critical to measurement of heritage assets. It is currently mentioned only briefly as a type of replacement cost (i.e., replace same asset or replace same capacity). Consideration should be given to providing more detail on this measurement basis to ensure the Measurement IPSAS covers all key measurement bases, even those that are anticipated to be used in future IPSASs.</p> <p>We suggest that more information about reconstruction (or “reproduction”) cost be included in the description of replacement cost (for example, a “replace same asset” versus “replace same capacity” discussion) since the heritage Agenda Item 11 for the IPSASB Sept-19 meeting mentions the use of reconstruction cost to measure some heritage items.</p>

Supporting Documents 6 – [draft] ED X, Improvements to IPSAS 5, *Borrowing Costs*

1. [draft] ED X, Improvements to IPSAS 5, Borrowing Costs, is included for members who wish to provide editorial comments outside of the June 2020 meeting.
2. Staff will bring the document for approval in September 2020.
3. Grey shaded text was reviewed by the IPSASB in March 2020.

Exposure Draft XX
Month, 2020
Comments due: Month [XX], [XXXX]

IPSAS[®]

Proposed International Public Sector Accounting Standard[®]

Improvements to IPSAS 5, Borrowing Costs

IPSASB

International Public
Sector Accounting
Standards Board[®]

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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 Exposure Draft, Improvements to IPSAS 5, *Borrowing Costs*, 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 [DATE].**

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. The approved text is published in the English language.

Objective of the Exposure Draft

Exposure Draft (ED) XX, Improvements to IPSAS 5, *Borrowing Costs*, deals with non-substantive changes to IPSAS that arose through comments received from stakeholders in response to the IPSASBs Consultation Paper, *Measurement*.

Based on stakeholder responses, the IPSASB agreed to retain the existing policy choice whether to expense or capitalize qualifying borrowing costs. The IPSASB also agreed to develop Implementation Guidance and Illustrative Examples to better explain the concepts of qualifying asset and directly attributable.

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 Specific Matters for Comment requested for the Exposure Draft are provided below.

Specific Matter for Comment 1:

Do you agree with the IPSASBs proposal that the policy choice available to capitalize or expense borrowing costs directly attributable to a qualifying asset is retained for the public sector? If not, why not?

Specific Matter for Comment 2:

Do you agree with the guidance developed in the illustrative examples and implementation guidance? If not, what further guidance is necessary?

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 5.

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Revision of IPSAS 5 as a result of the IPSASB's Consultation Paper, *Measurement*, issued in April 2019

- BC3. In April 2019, the IPSASB published a Consultation Paper, *Measurement*. The Consultation Paper proposed a comprehensive framework outlining how measurement bases should be determined when applied in the context of IPSAS. One of the objectives of the Consultation Paper was to consider the existing requirements on accounting for borrowing costs in IPSAS 5, *Borrowing Costs*.
- BC4. The Consultation Paper discussed the accounting policy choices permitted in IPSAS 5 for accounting for borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset: capitalization or immediate recognition as an expense.
- BC5. The Board proposed to eliminate the option to capitalize borrowing costs in order to:
- (a) Address a public sector issue where borrowing is centralized and determined for the economic entity as a whole. Expensing borrowing costs lessens the burden of attributing centralized borrowing costs to specific projects within the public sector;
 - (b) Enhance comparability between the cost of asset acquisitions, productions or constructions between public sector entities; and
 - (c) Align more closely with the requirements in the Government Finance Statistics Manual.
- BC6. In developing its preliminary view, the Board acknowledged the complexity of the issue. This complexity, and opposing views on what should be included in cost, resulted in responses to the preliminary view being split with many respondents supporting the Board's proposal, and equally, many respondents disagreeing. Those that disagreed noted the reasons to remove the existing accounting policy choice were insufficient, arguing that:
- (a) Difficulties in attributing borrowing costs to specific projects in the public sector are exaggerated and are an insufficient reason to diverge from private sector accounting treatment. Large conglomerates in the private sector face similar challenges and are able to capitalize borrowing costs;
 - (b) Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are part of the cost of that asset. During the period when an asset is under development, the expenditures for the resources used must be financed. Financing has a cost. The cost of the asset should include all costs necessarily incurred to get the asset ready for its intended use or sale, including the cost incurred in financing the expenditures as a part of the asset's acquisition, construction or production cost;
 - (c) Capitalizing directly attributable borrowing costs enhances accountability and decision; and
 - (d) Immediate expensing of borrowing costs leads to inconsistency in treatment with the requirement to capitalize transaction costs directly attributable to the acquisition of an asset.
- BC7. Having reviewed the responses, the Board concluded the existing accounting policy best represented the diversity in views and should be maintained.

BC8. The Board observed the existing accounting policy choice is consistent with the measurement principles in the Conceptual Framework and allows preparers of public sector financial statements to weigh the qualitative characteristics of useful information when selecting an approach that most faithfully represents the cost of the asset.

BC9. Further supporting its conclusion to maintain the accounting policy choice, the Board noted the following:

- (a) The technical merits of capitalizing borrowing costs or expensing borrowing costs both have value. In some cases, respondents took opposite views: for example, on whether borrowing costs are an attribute of the cost of an asset;
- (b) The goal of the approach when accounting for borrowing costs is to assist financial statement users in obtaining the most appropriate reflection of costs to acquire, construct or develop an asset, which may in some cases include borrowing costs;
- (c) While at certain levels of government the allocation of borrowing costs is challenging, at other levels, such as at local governments, it can be relatively straightforward;
- (d) Capitalization of borrowing costs would align with IFRS where that is an economic entity's preferred approach, whereas the expensing of borrowing costs would demonstrate alignment with GFS if that is an economic entity's preferred approach; and
- (e) There must be a clear benefit to expensing borrowing costs. Since there are unavoidable costs in eliminating an accounting policy choice, the Board carefully considers the costs and benefits of any new pronouncement. In this case, the Board has not been told that preparers who elected to capitalize borrowing costs under IPSAS 5 found doing so unnecessarily burdensome.

BC10. In order to support those respondents that identified practical public sector challenges in capitalizing borrowing costs, the Board developed Implementation Guidance and Illustrative Examples to address the application of the concepts of Qualifying Asset and Directly Attributable.

Distinction between borrowing costs and transaction costs

BC11. Some respondents proposed that the accounting treatment of borrowing costs and transaction costs should be consistent because they considered either:

- (a) Borrowing costs to be a type of transaction costs. Borrowing costs are directly attributable to the borrowing (for example, the issuance of a government financial instrument). Therefore, they meet the criteria of a transaction cost; or
- (b) Transaction costs to be a type of borrowing costs. Some respondents proposed this view based on the methodology applied in calculating the effective interest rate of a financial instrument. This is because some transaction costs are added to, or subtracted from, the principal amount of a financial instrument when determining the gross proceeds of a borrowing in order to determine the effective interest rate.

BC12. The Board considered these views, but maintained that borrowing costs and transaction costs are different economic phenomena. The Board concluded it is appropriate for the accounting principles to differ for each type of "cost" depending on the facts and circumstances.

BC13. In reaching this view, the Board noted that borrowing costs comprise interest and other expenses incurred by an entity in connection with borrowing funds. Borrowing costs are often contractually

linked to the underlying borrowing. Should the borrowing be transferred, the borrowing costs would either be transferred to the new counterparty or separated contractually. For example, Entity A has a mortgage with a fixed interest rate with a financial institution. Entity A pays Entity B to take over the mortgage. This transfer includes all future principal and interest payments.

- BC14. Transaction costs are incremental costs directly attributable to the transaction. However, transaction costs are independent of the contractual terms of the instrument. Should the item be transferred, the entity transferring the item is generally not compensated for the transaction costs because they are not transferred to the counterparty assuming the item. For example, Entity A paid a transaction fee equal to 1% of the mortgage balance to enter into the transaction with the financial institution. Entity A pays Entity B to take over the mortgage. However, while the transfer includes all future principal and interest payments, it excludes the transaction costs Entity A incurred to enter into the transaction with the financial institution.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 5.

Timing of Qualifying Assets

- IE1. On March 31, 20x1, Municipality XYZ begins construction of a tunnel to accommodate transit between two commercial hubs. The construction period is 5-years and the project is budgeted to cost CU100 million (CU20 million per year is paid to the construction company on March 31 of each year). Municipality XYZ issues a 25-year CU100 million bond on March 31, 20x1 that yields a fixed coupon of 5 percent per annum.
- IE2. On December 31, 20x1, the Municipality has accrued borrowing costs of CU3.75 million (CU100 million x 5 percent x 9/12 months). In determining the borrowing costs that can be included in the cost of the tunnel, the Municipality is limited to the actual amount incurred in the production of the qualifying asset.
- IE3. At December 31, 20x1, Municipality XYZ recognizes their tunnel asset as a work in progress. The amount capitalized is CU20.75 million (CU20 million + CU20 million x 5 percent x 9/12 months). This represents the funds transferred to the construction company and the borrowing costs associated with that amount. Municipality XYZ recognizes interest expense of CU3 million (CU80 million x 5 percent x 9/12 months) related to borrowing costs not specifically associated with expenditures on construction of the tunnel.

Centralized Borrowing Program – Eligible Borrowing Costs

- IE4. The Department of Infrastructure begins constructions of a new road network on June 15, 20x1. The project costs are budgeted to be CU500 million. All financing required by the Department of Infrastructure, and all other government departments, is secured centrally by the Department of Finance.
- IE5. The Department of Finance estimates its cash flow needs on an annual basis in order to determine the most appropriate source of funding to meet its internal lending needs. These sources include tax revenue, fee revenue, bonds issuances and loans.
- IE6. The Department of Infrastructure negotiates a 10-year loan from the Department of Finance. The Department of Finance requires the Department of Infrastructure to pay borrowing costs of three percent per annum. This is consistent with the market rate of interest the Department of Infrastructure would incur if the arrangement was negotiated at arm's length.
- IE7. When the Department of Infrastructure secures financing from the Department of Finance, the Department of Infrastructure is aware borrowings comprise various sources, but has no visibility into how the Department of Finance sources the funds, nor the weighted average borrowing costs the Department of Finance incurs.
- IE8. In determining the borrowing costs eligible for inclusion in the cost of the road network, the Department of Infrastructure includes only those borrowing costs which itself has incurred. Since the loan is at market terms the Department of Infrastructure concludes there are no concessionary elements and determines borrowing costs eligible for inclusion in the cost of the road network are based on the interest rate of 3 percent stated in the contract.

General Borrowing – Weighted Average Cost of Borrowing

- IE9. State Government T has begun construction of a new airport. The cost of this Airport is budgeted to be CU500 million. State Government T manages its own borrowings; however, it does not borrow for specific projects. In determining its borrowing needs, State Government T budgets its cash short fall over a given period and ensures borrowings will cover its liquidity needs.
- IE10. Over the construction period, State Government T held three instruments that were open for the entire construction period:
 - State Bonds – CU1 Billion, yielding an annual rate of 5 percent;
 - Loan with Financial Institution A – CU300 million, with an annual interest rate of 7 percent; and
 - Loan with Financial Institution B – CU600 million, with an annual interest rate of 9 percent.
- IE11. In determining the amount of borrowing costs eligible for inclusion of the cost of the Airport, State Government T calculates the weighted average of the borrowing costs applicable to all borrowings of the entity outstanding during the period.

	A	B	C	D (B x C)
	Principal	Interest Rate	Proportion of Debt	Weighted Average
State Bonds	CU1,000 million	5 percent	1,000 / 1,900	2.63
Loan A	CU300 million	7 percent	300 / 1,900	1.11
Loan B	CU600 million	9 percent	600 / 1,900	2.84
Weighted Average				6.58 percent

- IE12. State Government T calculates the weighted average of the borrowing costs applicable to all borrowings of the entity outstanding during the period to be 6.58 percent.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 5.

A.1 Timing of Qualifying Assets

When applying the allowed alternative treatment, when can borrowing costs be included in the cost of the qualifying asset?

Where borrowings have been incurred specifically to fund an asset's construction, the costs of those borrowings cannot be capitalized in the period before the commencement of the activities necessary to get the asset ready for use. However, the activities necessary to get the asset ready for use encompass more than the asset's physical construction. They include technical and administrative work prior to the commencement of physical construction. However, they exclude holding the asset when no production or development that changes the asset's condition is being undertaken.

A.2 Limit on Capitalization

When applying the allowed alternative treatment, are borrowing costs included in the cost of the qualifying asset limited to the costs incurred in that period?

Yes. If a borrowing can be specifically associated with expenditures on construction or production of the asset, the amount of borrowing costs capitalized is limited to the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.

A.3 Asset funded through Appropriations

In many jurisdictions, the entity constructing the qualifying asset, is funded through an appropriation. If the entity constructing the qualifying asset is unaware of the underlying source of the funds, i.e., whether they are generated by tax revenues, general cash holdings or borrowings, is the entity required to consider the original source of the funds when it determines the amount that can be included in the cost of the qualifying asset when applying the allowed alternative treatment?

No. When an entity constructing the qualifying asset is funded through an appropriation, the entity may include in the cost of the qualifying asset only those borrowing costs which itself has incurred.

A.4 Asset funded through a Centralized Borrowing Program – Interest Rates

Centralized borrowings may be funded through several separate loan instruments. Each instrument may have a different rate. Does the entity constructing the qualifying asset and borrowing from the centralized borrowing agency apply the centralized borrowing agency's rate when including borrowing costs in the cost of the qualifying asset when applying the allowed alternative treatment?

No. The weighted average rate incurred by the borrowing entity is not relevant in the preparation of the financial statements of the entity constructing the qualifying asset. The entity can only include in the cost of the qualifying asset only those borrowing costs which itself has incurred. The entity considers only the interest rate it incurs in its arrangement with the centralized borrowing agency.

The entity must consider all facts and circumstances when determining the borrowing costs incurred in its arrangement with the centralized borrowing agency. In some cases, the interest rate stated in the terms of

the arrangement may not reflect the true borrowing costs associated with the funds received. When the entity identifies concessionary terms, the entity should apply the requirements in IPSAS 41, paragraphs AG118–AG127. Interest expense calculated using the effective interest rate method is eligible for inclusion the cost of the qualifying asset in accordance with this Standard.

A.5 Asset funded through an entity's own General Borrowing – Borrowings are not Specific to Qualifying Asset

When an entity constructing a qualifying asset manages its own borrowing program, but borrowings are not specific to the qualifying asset, how does the entity determine the borrowing costs directly attributable to the qualifying asset? This may occur when an entity uses cash on hand to fund the cost of a qualifying asset. This cash on hand is funded from general borrowings, tax revenue and other fees and transfers.

The amount of borrowing costs eligible for inclusion of the cost of the qualifying asset are determined using the weighted average of the borrowing costs applicable to all borrowings of the entity outstanding during the period.

The entity shall exclude from the weighted average calculation, those borrowings that are made specifically for the purpose of obtaining another qualifying asset until substantially all the activities necessary to prepare that asset for its intended use are complete.

A.6 Asset funded through Specific Borrowings – Range of Debt Instruments

Does an entity apply a weighted average of borrowing costs when multiple debt instruments are used to fund the cost of a qualifying asset?

Yes. An entity may not be able to fund the cost of a qualifying asset with a single debt instrument. When multiple debt instruments are used, the cost of borrowing is determined by calculating the weighted average of all the debt instruments used to fund the cost of the qualifying asset.

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