



EUROPEAN COMMISSION  
BUDGET

The Accounting Officer of the Commission

Brussels,  
BUDG.DGA1/RAB

Mr Ian Carruthers  
Chairman  
International Public Sector Accounting  
Standards Board (IPSASB)

**Comment letter on Consultation Paper *Measurement***

Dear Mr Carruthers,

We welcome the opportunity to comment on the above-mentioned Consultation Paper '*Measurement*' (the 'CP'). The following comments are made in my capacity as Accounting Officer of the European Commission (the 'EC') responsible for, amongst other tasks, the preparation of the consolidated annual accounts of the European Union, which comprise more than 50 European Agencies, Institutions and other European Bodies with an annual budget of more than EUR 140 billion<sup>1</sup>.

We would like to thank the International Public Sector Accounting Standards Board (the 'IPSASB') for this opportunity to contribute to the due process and we are pleased to provide you with our comments with the aim of improving the transparency, relevance and comparability of the financial statements across jurisdictions.

We support the IPSASB's approach to align public sector accounting standards with International Financial Reporting Standards (the 'IFRS'), whenever the nature of the transaction is economically the same, and any public sector specific issues are addressed separately.

The EC welcomes the discussions on measurement as we consider measurement a fundamental aspect of financial reporting, in particular we welcome the proposal to provide guidance on fair value and the fact that the proposed guidance is based on IFRS 13 *Fair Value Measurement*.

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<sup>1</sup> For the sake of clarity, the views presented in this comment letter do not represent the views of the EU Member States, or the views of European Public Sector Accounting Standards ('EPSAS') team, and are without prejudice to future decisions which may be taken in the context of the EPSAS project.

Overall, the EC agrees with the proposals included in the CP and we consider that this guidance will fill a gap in the IPSAS literature. Nonetheless, in order for the guidance to be complete we consider that it should include all measurement bases.

Our detailed comments are provided in the Appendix to this letter.



Rosa ALDEA BUSQUETS

cc: Nicole Smith (DG.BUDG. DGA1.C), Derek Dunphy, Martin Koehler, Bruno Gomes, Magdalena Zogala (DG.BUDG.C2), John Verrinder (ESTAT.C1)

## Appendix – Response to the questions raised in the Consultation Paper (CP)

### Question (Preliminary View 1) – Which measurement bases needed guidance

*The IPSASB's Preliminary View is that the fair value, fulfilment value, historical cost and replacement cost measurement bases require application guidance.*

*Do you agree with the IPSASB's Preliminary View?*

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

#### **Response**

The EC fully supports the introduction of an IPSAS standard providing application guidance for the measurement bases to which the overall principles are set out in the IPSAS Conceptual Framework ('IPSAS CF'). We find the proposed guidance useful and necessary.

Nevertheless, we consider that in order to achieve its objectives<sup>2</sup> the future measurement standard should not be restricted to certain measurement bases, but rather be extended to all the measurement bases listed in the consultation paper (Figure 2.1), thereby achieving completeness from a conceptual point of view. In this regard, we understand the distinction between market value and fair value is a matter that will be discussed in the context of the Conceptual Framework Limited-Scope Review project, whether the outcome of this project confirms market value as a separate measurement base, application guidance should be included in the future measurement standard.

Finally, the EC welcomes the introduction of the concept of fair value as defined in IFRS 13 in the IPSAS literature as we believe that the same terminology used in IPSAS/IFRS should mean the same in substance and fair value as applied in the private sector is for many transactions which are economically the same also an appropriate measurement base for the public sector.

### Question (Preliminary View 2) – Whether guidance should be generic

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

*Do you agree with the IPSASB's Preliminary View?*

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

<sup>2</sup> Illustrative Exposure Draft establishes that "the objective of this Standard is to define measurement bases that assist in reflecting fairly the cost of services, operational capacity, and financial capacity of assets and liabilities and how to identify approaches under those measurement bases to be applied through individual IPSAS to achieve the objectives of financial reporting".

## **Response**

In line with our comments on the Preliminary View ('PV') 1, the EC supports the Board's view of issuing an IPSAS standard with generic guidance on measurement. We consider that given the specificities and judgement needed to measure the elements of the financial statements and its application across IPSAS standards, the generic guidance will assist public sector entities bridging the requirements in current IPSAS with the principles of the IPSAS CF.

We agree that the transaction specific guidance should rather be incorporated in the specific IPSASs addressing that transaction. Even though we understand that disclosures are not in the scope of this project, we take the opportunity to comment that, from our perspective, disclosures that would be required for items across the IPSAS standards should be required under the measurement standard and not repeated in each single IPSAS, such as the disclosure of fair value hierarchy.

### **Question (Preliminary View 3) – Whether guidance on historical cost is complete**

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

*Do you agree with the IPSASB's Preliminary View?*

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

## **Response**

Generally, the EC considers the generic guidance on historical cost put forward by IPSASB very useful. In our view, it supports the consistent application of the specific IPSASs and provides useful generic guidance applicable to many accounting transactions.

Nevertheless, we would like to comment on the following points of the guidance:

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

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/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.

We understand that paragraph C4 of the illustrative ED the IPSASB provides two changes in substance to the above:

- a) 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).

- b) 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.

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.

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

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: (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 (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).

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).

#### **Question (Preliminary View 4) – Whether guidance on fair value is complete**

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

*Do you agree with the IPSASB's Preliminary View?*

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

## **Response**

The EC fully supports IPSASB's view that clarifying guidance on the term fair value in the IPSAS literature was necessary since it may lead to many misunderstandings of readers of the two suites of standards. We agree that IFRS 13 is appropriate for the public sector for transactions that are economically the same as the ones in the private sector. This point is particularly relevant for the EC due to the interconnection of our activities with private sector partners.

Furthermore, we agree with IPSASB's view that assumption of the highest and best use must be taken into account in calculating the fair value of a non-financial asset. Without this requirement, we consider that there could be room for a higher level of subjectivity and discretion in the valuation of a non-financial asset, and consequently in the financial statements.

### **Question (Preliminary View 5) – Whether guidance on fulfilment value is complete**

*The IPSASB's Preliminary View is that fulfilment value guidance should be based on the concepts developed in the Conceptual Framework, expanded for application in IPSAS. The IPSASB considers **Appendix B: Fulfilment Value–Application Guidance**, to be complete.*

*Do you agree with the IPSASB's Preliminary View?*

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

## **Response**

The EC supports the proposed guidance for fulfilment value.

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.

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.

“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.”

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.

Consequently, we suggest that the IPSASB should clarify the interaction between the new guidance on fulfilment value and IPSAS 19.

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.

**Question (Preliminary View 6) – Whether guidance on replacement cost is complete**

*The IPSASB's Preliminary View is that replacement cost guidance should be based on the concepts developed in the Conceptual Framework, expanded for application in IPSAS. The IPSASB considers **Appendix D: Replacement Cost–Application Guidance**, to be complete.*

*Do you agree with the IPSASB's Preliminary View?*

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

**Response**

We agree with IPSASB proposal.

**Question (Preliminary View 7) – Borrowing costs: Proposal to expense**

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

*Do you agree with the IPSASB's Preliminary View?*

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

**Response**

In our view the proposed principle that all borrowing costs should be expensed rather than capitalised has its merits as it provides preparer with a clear approach which would



be easy to apply and easy to understand. However, we acknowledge that there may be circumstances in the public sector where an entity would be able to directly attribute the borrowing costs to the acquisition, construction or production of a qualifying asset. In these circumstances, an entity would be able to comply with the principle<sup>3</sup> that the cost of an asset should include the purchase price and other costs directly attributable to the acquisition or issuance of the asset. In the public sector, legal provisions may exist which limit the possibility for entities to borrow money to finance specific assets (e.g. the construction of an office building) combined with the obligation for the entity to submit the financing plan (i.e. maximum level of financing, financing period, type of financing, financing conditions and savings compared to other forms of financing) for that specific asset to Parliament for approval. Under these circumstances the alternative option (Option 3) may result in more relevant information for users of financial statements.

#### **Question (Preliminary View 8) – Transaction costs: Definition**

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

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

*Do you agree with the IPSASB's Preliminary View?*

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

#### **Response**

We agree with the proposed definition of transaction costs.

#### **Question (Preliminary View 9) – Where should the guidance be addressed?**

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

*Do you agree with the IPSASB's Preliminary View?*

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

#### **Response**

The EC fully supports IPSASB's view.

<sup>3</sup> Underlying principle set out in several IPSAS as to what should be included in the cost of the asset. This is included for example in the following standards: IPSAS CF.7.15; IPSAS 16.28; IPAS 17.30(b); and IPSAS 31.34(b).



**Question (Preliminary View 10) – Transaction costs when entering into a transaction**

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

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

*Do you agree with the IPSASB's Preliminary View?*

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

**Response**

We agree with IPSASB's view.

We understand however that the CP is focused particularly on fixed assets and we consider the question on capitalisation of transaction costs may also occur under other types of assets, such as the cost of an investment of an associate or joint venture.

In accordance with paragraph 16 of IPSAS 36 *Investment in Associates and Joint Venture*, under the equity method, on initial recognition, the investment is recognised at cost and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition.

Though the IPSAS 36 does not address the cost of an investment in associate or joint venture, in particular whether transaction costs should be capitalised, in our view, since generally the cost includes the purchase price and other costs directly attributable to the acquisition, transaction costs should also be capitalised in the cost of the investment.

IPSASB could take this opportunity to clarify upon this issue.

**Question (Preliminary View 11) – Transaction costs when exiting into a transaction**

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

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

*Do you agree with the IPSASB's Preliminary View?*

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

**Response**

We agree with IPSASB's view.

**Question (Specific Matter for Comment 1) – List of the definitions included in the illustrative ED**

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

*Do you agree that the list of definitions is exhaustive?*

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

***Response***

We consider the list of definitions is comprehensive. However, in line with our comment in PV1 we consider that 'market value' should be included in this list, subject to the conclusions on the limited review of the IPSAS CF. In addition, we suggest to include a definition of 'current value' following the incorporation of this term in an IPSAS.