



# Comments on IPSASB Consultation Paper: Measurement

## Contact Details

*Name: John Vessey*

L10, Majestic Centre, 100 Willis St  
PO Box 12 003, Wellington 6144  
New Zealand

Telephone: +64 4 471 7000  
Mobile: +64 27 4495 604

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*Prepared By*

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John Vessey  
Technical Principal Valuation

*Approved for Release By*

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Wayne Hatcher  
Technical Director Asset Management

**Preliminary View 1—Chapter 2 (following paragraph 2.6)**

The IPSASB's Preliminary View fair value, fulfillment value, historical cost and replacement cost require additional application guidance.

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

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

**Preliminary View 2—Chapter 2 (following paragraph 2.6)**

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

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

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

**Preliminary View 3—Chapter 2 (following paragraph 2.10)**

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

Do you agree with the IPSASB's Preliminary View? **No**

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

The current standards require a specialised asset to be accounted for using a single approach ie either historic cost or replacement cost. I believe there is a case to use a combination of HC and RC for some assets. For example, consider a national highway network asset. Such an asset is currently valued using RC methodology for all components. The earthworks to create the corridor profile and platform on which the road pavement sits, is a never repeated, one-off cost. It accounts for a very large proportion of the total cost of construction. For the New Zealand State Highway, it represents 36% of the construction price. In addition, there are numerous other one-off costs involved in the original corridor construction. The cost of renewing a highway asset is usually less costly than when the highway is originally constructed. Professional fees are generally much higher and then there is the cost spent on third party assets, either relocating them or restoring them. These costs never reoccur when the depreciable components of the highway undergo ongoing renewal. For the New Zealand State Highway network, these other one-off costs account for another 10% to 15% of the total construction cost. The combined proportion of non-depreciable costs can be close to 50% of the total construction cost.

I propose that these costs should be financially recorded at Historic Cost while the renewable portion of the highway asset is valued using the standard Replacement Cost methodology. Under the current standards, there is much confusion on how these costs should be treated in financial accounts and funded in an equitable way. An alternative solution would be to provide more guidance about what constitutes an item of property, plant and equipment in IPSAS 17 Property, Plant and Equipment, and to highlight that some components of assets may be recognized as separate items and accounted for separately. This may be something for the IPSASB to consider in its infrastructure assets project.

Separating the non-repeat cost in this way would simplify the funding side. These one-off costs could be equitably financed by a longterm interest only loan with interest cost treated as opx. The other assets can be equitably renewed by fully funding replacement cost depreciation.

**Preliminary View 4—Chapter 2 (following paragraph 2.16)**

The IPSASB's Preliminary View is that 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? **Yes**

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

**Preliminary View 5—Chapter 2 (following paragraph 2.28)**

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? **Yes**

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

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.

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.

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.

Again, this may be an issue worth exploring as part of the IPSASB's infrastructure assets project.

**Preliminary View 6—Chapter 2 (following paragraph 2.28)**

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

Do you agree with the IPSASB's Preliminary View? **No**

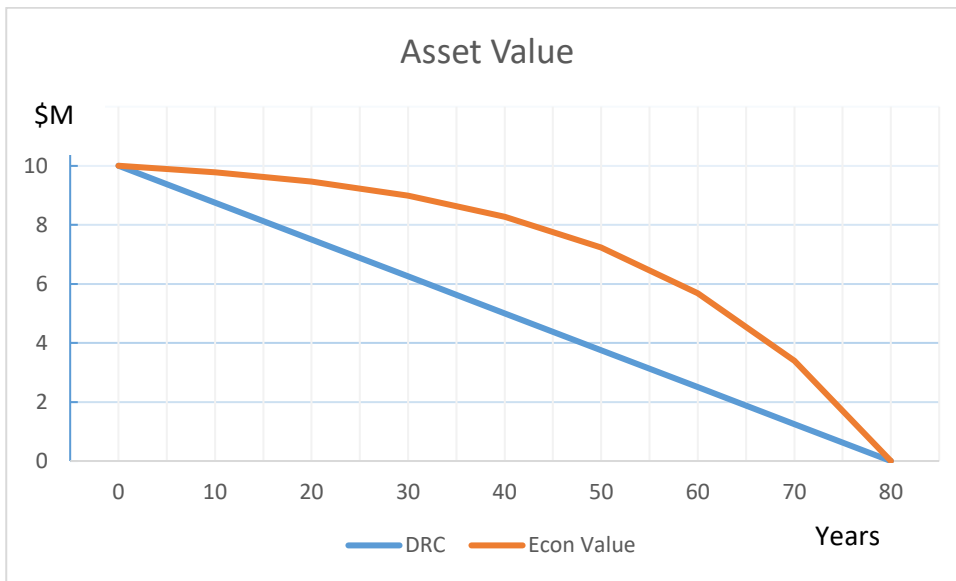
If not, please provide your reasons, stating clearly what you consider needs to be changed.

**Section D30 - Depreciated Replacement Cost**

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.

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  $\$RC_0 - (\$RC_{45} - \$RC_{80}) = \$10M (1 - 0.171 + 0.043) = \$8.7M$ . The two values are significantly different.

The difference between Depreciated Replacement Cost (DRC) and the Economic Value is illustrated on the following diagram.



The entry value for 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.

**Section D38 – Phasing of Work**

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.

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.

**Section D40 – Contract Variations**

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 of service. It would be entirely appropriate to include the value added by these changes.

**Preliminary View 7—Chapter 3 (following paragraph 3.28)**

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

Do you agree with the IPSASB’s Preliminary View? **No**

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

The cost of capital expenditure over the construction period (i.e up until the asset becomes operational) should be capitalised into the value of the asset. From a valuer’s perspective, the cost

of holding capital” over the duration of construction has a real opportunity value. That capital could be used elsewhere to generate revenues or benefits. Diverting this capital to construction of a specific asset deprives the entity those other benefits. This loss of benefit is termed “opportunity cost” and should be fully reflected in the capital value of the constructed asset.

Once the asset becomes operational the debt servicing cost becomes an operating expense.

Holding costs during construction has opportunity value regardless of whether the agency is a public benefit entity or private business. The value of this cost depends on the discount rate which in turn depends on the agency’s risk profile and asset type. For Public Sector agencies the opportunity cost should take into account the duration of construction and the social opportunity cost of capital for the public sector agency.

#### **Preliminary View 8—Chapter 3 (following paragraph 3.36)**

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? **Yes**

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

#### **Preliminary View 9—Chapter 3 (following paragraph 3.42)**

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? **Yes**

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

#### **Preliminary View 10—Chapter 3 (following paragraph 3.54)**

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

- Excluded in the valuation of liabilities measured at fulfillment 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? **Yes**

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

#### **Preliminary View 11—Chapter 3 (following paragraph 3.54)**

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

- Included in the valuation of liabilities measured at fulfillment 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? **Yes**

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

#### **Specific Matter for Comment 1—Chapter 2 (following paragraph 2.29)**

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

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

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.

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

Guidance in International Valuation Standards (IVS) and Government Financial Statistics (GFS) has been considered as part of the Measurement project with the aim of reducing differences where possible; apparent similarities between IPSAS, IVS and GFS have been noted. Do you have any views on whether the IPSASB's conclusions on the apparent similarities are correct? **Yes**  
Do you agree that, in developing an Exposure Draft, the IPSASB should consider whether the concepts of Equitable Value and Synergistic Value should be reviewed for relevance to measuring public sector assets (see Addendum B)? **Yes**

**Specific Matter for Comment 3—Chapter 4 (following paragraph 4.21)**

Do you agree that the measurement flow charts (Diagrams 4.1 and 4.2) provide a helpful starting point for the IPSASB to review measurement requirements in existing IPSAS, and to develop new IPSAS, acknowledging that other matters need to be considered, including:

- The Conceptual Framework Measurement Objective;
- Reducing unnecessary differences with GFS;
- Reducing unnecessary differences with IFRS Standards; and
- Improving consistency across IPSAS. **Yes**

If you do not agree, should the IPSASB consider other factors when reviewing measurement requirements in existing IPSAS and developing new IPSAS? If so, what other factors? Please provide your reasons.

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