Office of the Auditor General of Canada
Bureau du vérificateur général du Canada

25 October 2021

International Public Sector Accounting Standards Board

International Federation of Accountants
277 Wellington Street West
Toronto, ON M5V 3H2

Re: Exposure Draft 76, *Conceptual Framework Update: Chapter 7, Measurement of Assets and Liabilities in Financial Statements*

Thank you for the opportunity to comment on the above Exposure Draft. I am responding on behalf of the Office of the Auditor General of Canada.

We are pleased to submit to the Board our response below to the specific questions posed in the Exposure Draft.

Sincerely,

Lissa Lamarche, CPA, CA

Assistant Auditor General

Specific questions posed by IPSASB:

Specific Matter for Comment 1:

ED 76 proposes a measurement hierarchy. Do you agree with the three-tier hierarchy?

If not, why not? How would you modify it?

Yes, we agree with the three-tier hierarchy in principle. However, we think Diagram 1 could be improved.

The basic function of a hierarchy is to simplify information which allows for better decision making. The proposed hierarchy, while it does serve to simplify measurement principles by separating them into three tiers, does not contain guidance explaining how this hierarchy would be applied in practice. We note that Chapter 7 does provide some limited guidance on the circumstances for which each measurement basis might be used, however, this information is not displayed as the hierarchy diagram does not go to this level of detail. We think it would be beneficial if the diagram also identified the key characteristics that support each measurement basis as this would help stakeholders to operationalize the hierarchy. For example, providing some guidance on when fair value would be a relevant measurement basis versus current operational value would be helpful. Likewise, guidance on when cost of fulfillment would be more relevant than fair value would also be helpful. While the proposed measurement chapter does provide some of this information in the various paragraphs, we think the hierarchy diagram would be more useful if it also captured the information needed to help stakeholders determine which model and basis to use.

Specific Matter for Comment 2:

Do you agree with the proposed inclusion of fair value as a measurement basis for assets and liabilities with the same definition as in IFRS 13, *Fair Value Measurement*, in the Conceptual Framework?

If not, why not?

Yes, we agree with the proposed inclusion of fair value as a measurement basis for assets and liabilities with the same definition as in IFRS 13, *Fair Value Measurement*. Using different terms for fair value in different standards can lead to confusion and a lack of understandability and therefore we support IPSASB's desire to maintain common definitions.

Many public sector entities hold assets and liabilities for many of the same reasons they are held by private, for-profit entities. Therefore, in our view fair value remains a relevant measurement basis for many public sector assets and liabilities such as financial assets and financial liabilities. On that basis, we support the inclusion of fair value in the Conceptual Framework.

Specific Matter for Comment 3:

Do you agree with the proposed inclusion of current operational value as a measurement basis for assets in the Conceptual Framework?

If not, why not?

The Exposure Draft includes an Alternative View on current operational value.

No, we do not agree with the proposed inclusion of current operational value as a measurement basis for assets in the Conceptual Framework. While we understand the IPSASB's objective in developing current operational value, we are not persuaded that it is necessary. As indicated in our response to Specific Matter for Comment (SMC) 5 in ED 77, Measurement, we note the following issues with this measurement basis as currently proposed:

1) Challenges in applying fair value have been overcome in Canada by our other government organization (OGO) entities that follow IFRS and, in fact, we believe that IFRS 13 already contains some helpful guidance to consider when valuing non-financial assets, especially those that are specialized. For example, the cost approach can be used when there is no observable market as suggested by IFRS 13.BC79 and the cost approach, as worded in IFRS 13.B8-B9, does not necessarily imply highest and best use. In addition, IFRS 13.29 indicates that an "entity's current use of a non-financial asset is presumed to be its highest and best use", unless there is evidence to the contrary. Therefore it seems that another measurement basis may not be necessary if the existing fair value measurement basis in IFRS can be successfully used for non-financial assets, whether held for their financial or operational capacity.

2) As noted in ED 77.BC58, "the primary measurement objective, and in turn the measurement basis, is determined for each individual asset or class of assets". Having different current value measurement bases within a set of public sector financial statements, within a class of assets, or even between individual assets, may decrease comparability between assets and between entities with similar asset types, as well as decrease understandability due to the different measurement bases being applied within comparable entities or even within a set of financial statements. In addition, we think this will also increase complexity for preparers, auditors, users, and valuation experts without enhancing accountability or decision-making as this can be achieved by applying IFRS 13 principles without the need for a different current value measurement basis. Adopting a new measurement basis requires significant effort for users, valuation experts, auditors and preparers to understand and implement; if comparability and understandability of financial statements is reduced between comparable entities and/or assets, it is hard to justify that the benefit outweighs the cost of implementation.

3) Current operational value is defined in paragraph 7.48 as "*the value of an asset used to achieve the entity's service delivery objectives at the measurement date*" which seems consistent with the concept of current replacement cost under the cost approach in IFRS 13.B8-B9. Therefore, with the exception of the treatment of transaction costs, it is unclear how a current operational value measurement would yield a different result than using the cost approach under fair value. We think this lack of differentiation between the definitions diminishes the justification for introducing a new measurement basis. Furthermore, we note that current operational value as it is proposed considers only current use which seems to limit the value unnecessarily in that it may not ultimately reflect the full operational value to the entity as explained further in item 4) below.

4) IPSASB indicated in ED 77.BC29 (a) that highest and best use was a concept that may not be generally applicable in the public sector when an item is held for its operational capacity. While we agree that certain aspects of the concept of highest and best use may not be applicable in this particular context, we think other aspects of this concept are applicable and necessary to consider so that the measurement objective in ED 76.7.2 is met. For example, we agree that a school should not be measured as if it was a condominium even if that would maximize the value for market participants; however, we think that the narrower concept of alternative uses that incorporates the value derived from the asset's ultimate disposal, if any (e.g. proceeds that could be used to invest in a more technologically advanced asset), which in turn would maximize the resources available to the public sector entity and allow it to continue delivering services to the public, does have applicability for non-financial assets held for their operational capacity. In our view, this narrower concept discussed in IFRS 13.BC71 can be adapted for non-financial assets held for their operational capacity so that the value of the asset to the entity is maximized. By considering only the asset's current use as outlined in ED 76.7.49 and not considering alternative uses that would seek to maximize the value to the entity, we do not think that the measurement objective in ED 76.7.2 is met as the value would not reflect the full operational value to the entity. Consequently, we think the measurement objective for non-financial assets would be better met by including additional guidance that supplements existing concepts in IFRS 13 for these types of assets.

5) This ED notes that current operational value is explicitly an entry price whereas fair value is an exit price. However, we note that the views of IPSASB members were divided in regards to whether the proposed guidance on current operational value, when applying an income approach measurement technique, is consistent with an entry price perspective (refer to ED 77.AV2, .AV14). We note that IFRS 13.BC79 allows current replacement cost as a cost approach measurement technique and IFRS 13.B141 states that although replacement cost might be more consistent with an entry price, the IASB concluded that the entry price and exit price would be equal in the same market. In relation to the valuation premise for specialized non-financial assets, we interpret IFRS 13.BC78 to imply that market-participant-based assumptions in these cases would be the same as the assumptions used by the entity holding the asset because, in effect, the market participant buyer steps into the shoes of the entity that holds that specialized asset; while this paragraph discusses specialized assets, we think these concepts could be applied to other non-financial assets held for their operational capacity. In our view, the fact that both fair value and current operational value are not strictly limited to entry or exit prices in all cases narrows any perceived differences between the two measurement bases for some non-financial assets, which in turn calls into question the need for two distinct current value measurement bases for these types of assets.

On this basis, we would encourage the IPSASB to re-evaluate whether there is in fact a need for a new measurement basis or whether the existing concepts contained in IFRS 13 as it relates to determining fair value for specialized or other non-financial assets could be supplemented with additional guidance on how to apply IFRS 13 concepts to any non-financial asset that is held primarily for its operational capacity. We think that such an approach would be less complex, less costly and would lead to an increase in comparability between similar entities when measuring their non-financial assets as well as an increase in understandability, by reducing the number of different measurement bases available within comparable entities for comparable assets and within a set of financial statements, rather than a decrease. This would also better align with those public sector entities that apply IFRS. We think that if other jurisdictions have been able to apply IFRS 13 principles for use in valuing non-financial assets held for their operational capacity in their public sector entities, that this approach would be preferable to the introduction of a new current value measurement basis.

Specific Matter for Comment 4:
It is proposed to substitute a general description of value in use (VIU) in both cash-generating and non-cash-generating contexts, for the previous broader discussion of VIU. This is because the applicability of VIU is limited to impairments. Do you agree with this proposed change?
If not, why not? How would you approach VIU instead and why?

No, we do not agree with the proposed change. While we do not disagree with the proposal to remove VIU as a measurement basis and discuss it more generally in the Conceptual Framework, we think that should the IPSASB proceed with the introduction of current operational value, the distinction between VIU and this new measurement basis, which are both entity-specific measurements based on current use, should be clarified.

We note that the definition of current operational value in paragraph 7.48 of "*the value of an asset used to achieve the entity's service delivery objectives at the measurement date*" is similar to the definition of VIU of a non-cash generating asset in paragraph 7.59 which states "the asset's remaining service potential at the measurement date". The difference between these two concepts is therefore unclear. While VIU is no longer listed as a measurement basis, it is a current value measurement used when determining impairment, and thus we think it is important for IPSASB to explain the difference. The fact that one measurement is used only for impairment does not explain how these two measurements are meant to differ. Therefore, we think that IPSASB should provide additional context by further explaining not only what VIU is but how it differs from current operational value in order to avoid confusion.

Specific Matter for Comment 5:
Noting that ED 77, *Measurement*, proposes the use of the cost approach and the market approach as measurement techniques, do you agree with the proposed deletion of the following measurement bases from the Conceptual Framework:
• Market value—for assets and liabilities; and
• Replacement cost—for assets?
If not, which would you retain and why?

Yes, we agree with the proposed deletions of market value and replacement cost as measurement bases. However, as explained further below we think that guidance should be included on replacement cost since this concept is used to refer to the cost approach measurement technique under both current value measurement bases in ED 77.

While we do not see an issue with the proposed removal of replacement cost from the Conceptual Framework as a measurement basis, as mentioned in our response to SMC 6 in ED 77, we think that guidance is still needed on the concept of replacement cost which is discussed in the following paragraphs in ED 77:

- Definition of the cost approach in paragraph 6;
- Paragraph 43 in relation to the cost approach for both fair value and current operational value;
- Paragraph B29 in relation to the cost approach for current operational value; and
- Paragraph C33 and C34 in relation to the cost approach for fair value.

Therefore, we think it would be important to include guidance on replacement cost since it will still be used to value assets under both current value measurement bases when using the cost approach as a measurement technique. On that basis, we would encourage the IPSASB to consider retaining and/or enhancing the existing guidance in paragraphs 7.37-7.48 of the existing Conceptual Framework and consider adding such guidance to ED 77 which discusses the various measurement techniques.

Specific Matter for Comment 6:

The IPSASB considers that the retention of certain measurement bases that were in the 2014 Conceptual Framework is unnecessary. Do you agree with the proposed deletion of the following measurement bases from the Conceptual Framework?

• Net selling price—for assets

• Cost of release—for liabilities

• Assumption price—for liabilities

If not, which would you retain and why?

Yes, we agree with the proposed deletions since these measurement bases are used rarely, if at all.

Specific Matter for Comment 7:

Are there any other issues relating to Chapter 7: Measurement of Asset and Liabilities in Financial Statements of the Conceptual Framework that you would like to highlight?

Yes, we note the following other issues relating to Chapter 7: Measurement of Assets and Liabilities in Financial Statements of the Conceptual Framework that we would like to highlight:

- We have had challenges in the past applying the concept of "market" to fair value measurements in a public sector context. This ED discusses market in terms of fair value measurements and ED 77 discusses market in terms of both fair value and current operational value measurements, however this term is not defined within a public sector context. Given that ED 77 allows the use of the market approach as a measurement technique for both fair value and current operational value measurement bases, we think market needs to be defined in these contexts in order to achieve comparability and consistency in the application of the proposals as mentioned in our response to SMC 5 in ED 77.

- Linked with the concept outlined directly above, we have also had challenges applying the concepts in IFRS 13.19-.20 related to access to the principal (or most advantageous market) at the measurement date in a public sector context when measuring financial assets and liabilities. Public sector entity mandates and permissible powers outlined in legislative acts often place legislative restrictions on assets and/or liabilities, both financial and non-financial. Key examples include the authority to borrow on the market versus use of a centralized government borrowing program, as well as the authority to sell / pledge assets. While one could argue that such legislative restrictions would effectively deny access to certain markets, one could equally argue that such legislative restrictions do not prevent an entity from accessing the principal market and determining fair value in that market. In that case, while the entity may not be in compliance with their governing authorities if they were to use such a market, there is no legal restriction preventing the entity from accessing such a market. On the other hand, one could also argue that legislative restrictions on assets / liabilities effectively create unique markets given the particularities involved in a public sector context. We encourage IPSASB to provide additional guidance on how legislative restrictions impact fair value measurements, especially in light of the fact that this is a common fact pattern across public sector entities.

- Finally, we noted a small typo in paragraph 7.16; there is an extra “s” in the first line.