Exposure Draft 77

Proposed International Public Sector Accounting Standard

"*Measurement*"

REQUEST FOR COMMENTS

Task force IRSPM A&A SIG, CIGAR Network, EGPA PSG XII

October 21st, 2021

The objective of ED 77 is to define measurement bases that assist in reflecting fairly the cost of services, operational capacity and financial capacity of assets and liabilities. ED 77 identifies approaches under those measurement bases to be applied through individual IPSASs to achieve the objectives of financial reporting. ED 77 Measurement defines the measurement bases and provides separate appendices that include guidance on how the bases are implemented in practice.

The comments and responses prepared by the Task Force IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are presented below. The IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are three research networks that focus on Public Sector Accounting. The Task Force is made up of 17 researchers from these networks. The views expressed in this document represent those of the members of the Task Force and not of the whole research community represented by the networks, and neither of the Institutions/Universities with which they are affiliated.

CORE ASSUMPTIONS

We are of the opinion that, in general, public sector entities require public sector specific principles and standards that properly accommodate public sector specificities. As such, when public sector transactions resemble those taking place in the private sector, then principles and standards may be kept as aligned as possible. However, for public sector specific transactions, we are in favour of standards that are not adapted artificially from private sector accounting and we think there is a need to seek options that best fit the public sector. This core thesis underpins our proposals and recommendations herein.

We welcome the opportunity to comment on ED 77. **Our response is in three parts**. It consists of a "**General Comment**", the proper "**Specific Matter Comments**" and "**Further Concerns**".

General Comment

The Specific Matters for Comment in the three EDs related to measurement, namely ED76, ED77 and ED78, do not cover some broader issues which we would like to highlight. These comments apply as well to our responses to ED76 and ED78.

In our opinion, the Conceptual Framework and/or the standards should provide structured guidance to orient (and even direct) the accounting policy choice concerning accounting measurement models and subsequent measurement bases and techniques. By avoiding to provide such guidance, the IPSASB is allowing weak reporting and mismanagement.

A conceptual framework may and should provide guidance to preparers in order to choose between measurement models. The conceptual framework may even limit the choices available, according to a coherent set of consistent indications, and it should define conditions under which preparers of financial statements in the public sector may use different measurement models, providing full explanation on these motivations. While we appreciate that subjectivity is inherent in financial reporting, we point out how important it is to minimize the extent that subjectivity is required to be exercised in public sector financial reporting, due to the scope of such reports to provide accountability to the citizens.

The IPSASB should emphasize the fact that most of the physical capital goods are non-monetary items, which means that a government owning and using those goods is not the owner of monetary units, but it holds only certain rights on those capital goods. Generally speaking, these rights are such that governments have the custody rights but without having usufruct, and facing restrictions on alienation rights. The non-financial characteristics of these assets are the main cause for difficulties in applying various valuation models, bases and techniques in the public sector.

One issue that we identify is the very introduction of a current value model with several bases and techniques, without a clear view on when this model can and should be applied. We agree that its usefulness is limited generally speaking, and its misrepresentation risks rank high in some circumstances.

In our responses concerning asset measurement, we tend to favour “replacement cost” as an alternative to “current operational value” because replacement cost is quite a straightforward value to determine. In fact, both seem to tend to increase the current resource needs (that is, current costs, supposed to be covered by current revenues) by the reporting entity, which is not going to renew those resources now and is not supposed to do it soon. When renewal occurs, the entity may have recourse to other sources than operational flows and related reserves, typically debt issuance. Therefore, the use of replacement cost or current operational value does violate intergenerational equity between current and future taxpayers.

Alternatively, reference could be made to "renewal accounting" or "fixed cost depreciation method", in which the carrying value of the asset is kept constant because of its constant service potential. Accordingly, depreciations are not booked, but efforts are made (and resources are employed) to ensure that constant service potential is maintained. Related expenditures are directly charged as expenses in the Statement of Financial Performance. This model is not considered by the IPSAS framework, despite the many potential examples, such as fire departments, libraries, health care equipment, and so forth, where a constant service potential is required.

To conclude, we highlight that, in our opinion, a standard on measurement as proposed by ED 77 is not really required. Most of the material on historical cost and current value models and related information needs, currently included in the ED 77, would be more useful if integrated with ED 76 as part of the Chapter 7 update. This would make Chapter 7 of the Conceptual Framework more complete and informative. If the IPSASB keeps seeing the need to issue a separate standard on fair value, the latter being in line with IFRS 13, then the IPSASB can elaborate this separate standard on fair value without negatively impacting the format and structure of the Conceptual Framework. In fact, the utility of a separate standard on fair value in the public sector is questionable, but this latter argument is beyond the scope of this comment on ED 76 and ED 77.

We wish to point out that, besides the points raised by the SMCs, we have highlighted other issues in ED77, which can be found at the end of our responses to the ED's SMCs.

Specific Matter for Comment 1—(paragraphs 7–16):

Do you agree an item that qualifies for recognition shall be initially measured at its transaction price, unless: • That transaction price does not faithfully present relevant information of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes; or • Otherwise required or permitted by another IPSAS? If not, please provide your reasons, stating clearly what principles are more appropriate, and why.

ED 77 proposes that, when the transaction price '*does not faithfully represent relevant information*', then the item should be initially recognized at a deemed cost that does so. A current value measurement technique can be used to estimate the deemed cost.

First of all, we would like to point out that the term 'deemed cost' can be confused with that found in IPSAS 33 First-Time Adoption. We suggest that the term 'estimated cost' is used instead.

Secondly, in our opinion, an item that qualifies for recognition shall be initially measured at its transaction price. There should be no other conditions attached to this because the transaction price is the most reliable and uncontested value. Any other initial measure would be subjective. For whatever reason, the item was acquired at a reliable transaction price, and this has to be reported. Using a different initial measure would distort the true and fair view. For accountability purposes, if in an unforced transaction, the price cannot be reliably measured, that accounting element should be disclosed – but not recorded as an entry in the accounting system.

If an item that qualifies for recognition has no transaction price, then no transaction should be recorded. The notes can disclose the existence of the item and even calculate a price that would faithfully present relevant information. The note should disclose this fact, including the technique underlying the valuation.

A government could receive items for a very low transaction price or free of charge. These could be investment goods, operational goods, funds (money) or services in kind. There are also more complicated situations, such as the government decides to cancel certain debts of e.g. citizens or a (partly) remission of paying interest on a loan is decided by a government, etc. The accounting records should follow the real transaction price and it is recommendable or even necessary to document fully in the notes the estimated value of these non-exchange transactions. For example, specific tables and templates have been developed by the French legislator for non-profit organizations so that these organizations can report the effects of voluntary activities by volunteers, donations and other non-exchange elements (see *RÈGLEMENT N° 2018-06 du 5 décembre 2018 Relatif aux comptes annuels des personnes morales de droit privé à but non lucratif*).

Furthermore, the proposed accounting treatment of the difference between transaction price and ‘deemed cost’ (or ‘estimated cost’ as suggested) – that is, to write it off as income/expenditure (Par. 11) – distorts performance reporting and provides window-dressing opportunities. Performance reporting should be kept clean and close to realized transactions, in view to assist controlling for budgeting execution.

Judgement is intrinsic in financial reporting. The underlying thinking of our response to SMC 1 is that, unlike financial statements in the private sector, public sector financial statements should avoid the need to exercise judgement as much as possible. Ideally, there should be no need for judgement because this undermines (puts at risk) reliability, accountability and transparency.

Having said this, should the IPSASB decide to proceed with ‘deemed cost’ (or ‘estimated cost’ as suggested), then we suggest further guidance to be provided which clearly explains for which assets and liabilities deemed cost (or ‘estimated cost’ as suggested) is feasible; as well as to better explain, with examples, which would be the difference among them, including the measurement technique to apply. Perhaps a measurement hierarchy would be applicable here.

Specific Matter for Comment 2—(paragraph 17):

Do you agree after initial measurement, unless otherwise required by the relevant IPSAS, an accounting policy choice is made to measure the item at historical cost or at its current value? This accounting policy choice is reflected through the selection of the measurement model.
If not, please provide your reasons, stating clearly what principles are more appropriate, and why.

We found this question a bit difficult to answer because of our different accounting backgrounds. Cultural backgrounds affect the approach to accounting preferences, namely, rules based or principles based. While we acknowledge the fact that IPSASs are mainly principles based, it is difficult to adopt this approach in the public sector of certain jurisdictions.

An accounting policy choice implies judgement by preparers without guidance. Guidance may inform judgement.

A standard may and should provide guidance to preparers in order to choose between measurement models. It may even limit their choice according to a coherent set of indications. However, the policy choice should not be restricted to the two models suggested by ED77, namely, historical cost or current cost. **Guidance on the applicability needs to be provided, and the standard should provide criteria to choose between different measurement bases/models.**

The fact that the current draft does not purport to provide such guidance appears one of its main limitations, paving the way to weak reporting, including window-dressing opportunities.

The existence of this accounting policy choice without structured guidance - and its potential update over time and by accounting element classes - reduces comparability between reporting entities.

Specific Matter for Comment 3—Appendix A (paragraphs A1–A6):

In response to constituents' comment letters on the Consultation Paper, *Measurement*, guidance on historical cost has been developed that is generic in nature (Appendix A: Historical Cost). Do you agree the guidance is appropriate for application by public sector entities?
If not, please provide your reasons, stating what guidance should be added or removed, and why.

To be in line with the initial measurement proposed by the ED, the definition of Historical Cost in A2 should reflect Deemed Cost (or 'estimated cost' as suggested): '*Historical cost is the cash or cash equivalents or the value of the other consideration given or received or deemed (or 'estimated') to be given or received, at the time, etc.*'.

Specific Matter for Comment 4—Appendix A (paragraphs A1–A6):

Do you agree no measurement techniques are required when applying the historical cost measurement basis in subsequent measurement?
If not, please provide your reasons, stating which measurement techniques are applicable to the subsequent measurement of an asset or liability measured at historical cost, and why.

In our response to SMC 1 of ED 76, we commented that we find an element of ambiguity in the definition of measurement techniques, because it leads one to expect these measurement techniques to include depreciation and amortization methods. But then BC.10, BC.14-15, and BC.21 (Pg. 143, 144, 145) make clear that this is not intended.

We would suggest that the definition for Measurement techniques is adjusted along these lines:

"*Measurement techniques are **approaches** to choose appropriate methods that estimate the amount at which an asset/liability is presented under the selected basis*".

Furthermore, it is not clear why 'Amortized Cost' is included in this Appendix (Page 20). Amortized Cost is an income approach technique, and it better fits the Current Value Model category. The reason given in BC.28 (Page 146) is not satisfactory. BC.28 explains that amortized cost is considered as historical cost for financial instruments. Therefore, it may better fit to be included in IPSAS 41.

Specific Matter for Comment 5—(paragraph 6):

Do you agree current operational value is the value of an asset used to achieve the entity's service delivery objectives at the measurement date?
If not, please provide your reasons, stating clearly what principles more appropriate for the public sector, and why.
The Exposure Draft includes an Alternative View on current operational value.

Current Operational Value is defined as the value of an asset used to achieve the entity's service delivery objectives at the measurement date (par. 6). This definition is not clear. Is it referring to the value of the asset that has already been used to date? Or the value that shall be used, as estimated at measurement date?

We find this definition ambiguous and not practical. We support the Alternative View on its preference for Replacement Cost.

Although our response appears to favor replacement cost as an alternative to current operational value for asset measurement, we wish to point out that, in fact, both seem to tend to increase the current resource needs (that is, current costs, supposed to be covered by current revenues) by the entity, which is not being to renew those resources now and is not supposed to do it soon. When renewal occurs, the entity may have recourse to other sources than operational flows and related reserves, typically debt issuance. Therefore, the use of replacement cost or current operational value does violate **intergenerational equity** between current and future taxpayers.

Specific Matter for Comment 6—Appendix B (paragraphs B1–B41):

Do you agree the proposed definition of current operational value and the accompanying guidance is appropriate for public sector entities (Appendix B: Current Operational Value)?
If not, please provide your reasons, stating clearly what definition and guidance is more appropriate, and why.

Current Operational Value is defined as the value of an asset used to achieve the entity's service delivery objectives at the measurement date (par. 6). The definition is not clear. Is it referring to the value of the asset that has already been used to date? Or the value that shall be used, as estimated at measurement date?

Appendix B could be more straightforward. In its current status, it presents conflicting issues.

Par. B2 further confirms the similarity of Current Operational Value with Current Replacement Cost. As stated in our response to ED 76, we suggest the use of the term Current Replacement Cost instead of Current Operational Value, because the term Current Replacement Cost is more self-explanatory.

Par. B14 to B17 further reinforce the preference for Current Replacement Cost. Furthermore, in BC.33 (Pg. 146), '*the IPSASB agreed that, when an asset is held for its operational capacity, the most relevant information to the users of financial information is the current value of the asset in its current use*' – meaning, the Current Replacement Cost.

B21 states that if another IPSAS requires or permits an asset to be initially measured at Current Operational Value, any difference between the transaction price and the current operational value is recoded as a gain or loss for the year, unless another IPSAS specifies otherwise. We do not agree with B21, for reasons already stated regarding Deemed Cost (or 'Estimated Cost' as suggested) in SMC1, that is, such an accounting treatment distorts performance reporting and provides window-dressing opportunities.

We draw attention to B38(b) [Page 27]. The example given to support the Income Approach refers to heritage items that are naturally occurring, implying that the value could be somehow determined by referring to cash inflows generated by tourism or a royalty. We strongly suggest replacing the example with a more appropriate asset that can be reliably measured.

Specific Matter for Comment 7—Appendix B (paragraphs B6–B7):

Do you agree the asset's current operational value should assume that the notional replacement will be situated in the same location as the existing asset is situated or used?
If not, please provide your reasons, stating clearly why the asset should be measured at a different value.

Yes, we do, if the assumption is applicable. The reporting entity may not be expected to replace the asset in question, making this assumption redundant. This matter demonstrates the subjectivity underlying the estimation of current cost, and therefore, the waste of resources in making such estimations, including through recourse to professional appraisal.

Specific Matter for Comment 8—(paragraphs B38–B39):

Do you agree the income approach is applicable to estimate the value of an asset measured using the current operational value measurement basis?
If not, please provide your reasons, stating clearly why the income approach is not applicable for measuring current operational value.
The Exposure Draft includes an Alternative View on current operational value.

No, we do not agree that the income approach is suitable for public sector accounting. The reasons are clearly stated in the **Alternative View**.

Specific Matter for Comment 9—Appendix C (paragraphs C1–C89):

In response to constituents' comment letters on the Consultation Paper, *Measurement*, guidance on fair value has been aligned with IFRS 13, *Fair Value Measurement* (Appendix C: Fair Value). Do you agree the guidance is appropriate for application by public sector entities?
If not, please provide your reasons, stating what guidance should be added or removed, and why.

In our opinion, Appendix C should be a standalone standard on Fair Value. A standard on measurement as proposed by ED 77 is not really required. Most of the material on historical cost and current value models and the related information would be more useful as part of Chapter 7 update. This would make Chapter 7 of the Conceptual Framework more complete and informative. Par. BC.55 (Page 150) supports this option.

Par. C24 states that, at initial recognition, any difference between transaction price and fair value should be recognized as a gain/loss in surplus/deficit. Similar to our comments on deemed value (or 'estimated' as suggested), such adjustments would be rather awkward to explain to the users and stakeholders. Par. C25 seeks to present instances when such a situation may arise. From all the examples provided, only (e) appears acceptable, that is, when the transaction takes place to achieve a specific social policy objective. Having said this, we still believe that such subjective judgements should be kept to a minimum, and the use of fair value should be considered only in particular circumstances.

We also support the approach indicated in BC.22 where the IPSASB accepts that the existence of accounting policy options reduces comparability between reporting entities. The IPSASB considered the options for measurement subsequent to initial recognition in existing IPSASs with a view to eliminating or reducing those options.

Specific Matter for Comment 10—Appendix D (paragraphs D1–D48):

In response to constituents' comment letters on the Consultation Paper, *Measurement*, guidance on cost of fulfillment has been aligned with existing principles in the Conceptual Framework and throughout IPSAS (Appendix D: Cost of Fulfillment). Do you agree the guidance is appropriate for application by public sector entities? If not, please provide your reasons, stating what guidance should be added or removed, and why.

The guidance in Appendix D is appropriate. We highlight the importance of Par. D19 confirming that the cost of fulfillment measure assumes that the entity will fulfill its obligations.

We further highlight Par. D24 stating that **the present value techniques are not compulsory**.

Specific Matter for Comment 11:

Do you agree measurement disclosure requirements should be included in the IPSAS to which the asset or liability pertains and not in ED 77? If not, please provide your reasons, stating clearly where the measurement disclosure requirements should be included, and why.

Yes. Perhaps ED 77 could include an outline of the disclosure requirements relating to an asset/liability that does not fit with a particular IPSAS.

Specific Matter for Comment 12:

Are there any measurement disclosure requirements that apply across IPSAS that should be included in ED 77, *Measurement*? If yes, please provide your reasons, stating clearly what the disclosures are, and why.

Perhaps ED 77 could include an outline of the disclosures that are usually required. Furthermore, a cost-benefit assessment could be carried out to determine which disclosures really add information value to the citizens.

Specific Matter for Comment 13:

Do you agree current value model disclosure requirements should be applied consistently across IPSAS? For example, the same disclosure requirements should apply to inventory and property, plant, and equipment when measured at fair value. If not, please provide your reasons, stating clearly which IPSAS require more or fewer measurement disclosures, and why.

Yes, we agree, but with some minor differences due to the nature and materiality of the asset. For example, the valuation technique used to determine the fair value of inventory and investment property would be different. Determining the fair value of financial instruments would require taking into consideration various factors that need to be disclosed.

Specific Matter for Comment 14:

Do you agree with the proposal disclosure requirements for items remeasured under the current value model at each reporting date should be more detailed as compared to disclosure requirements for items measured using the current value model at acquisition as proposed in Appendix E: Amendments to Other IPSAS. If not, please provide your reasons, stating clearly why disclosure requirements should be consistent for recurring items and non-recurring items measured using the current value model.

Yes, we always tend to agree with detailed disclosure requirements under the Current Value model. These enhance accountability. However, some disclosure requirements may be costly if they involve recourse to appraisers. A cost-benefit assessment should be included – possibly by preparers - as well as guidance on their scope and updating policy. If the cost of disclosures for the current value model becomes too high or exceeding benefits, the reporting entity may prefer the historical cost model.

Specific Matter for Comment 15:

Do you agree fair value disclosure requirements should include requirements to disclose inputs to the fair value hierarchy? If not, please provide your reasons, stating clearly why disclosure requirements for inputs in the fair value hierarchy are unnecessary.

Yes, we always tend to agree with detailed disclosure requirements. These enhance accountability. With respect to fair value this information is essential for users, especially if the value disclosed origins from (judgmental) level 3 inputs. Once again, we highlight the need for a cost-benefit assessment, since the cost of certain disclosures may prove expensive both in absolute terms and when compared to the value added.

FURTHER CONCERNS:

Par. 4: It is not clear why the measurement requirements of ED 77 do not apply to transactions accounted for in accordance with IPSAS 13 and IPSAS 32 (par. 4). BC.16 does not explain the limitation of scope[1]. Similarly, ED 77 does not apply to net realizable value (IPSAS 12) and value in use (IPSAS 21 and 26). This limits the utility of ED 77. Is it a standard on **measurement**? Or a **Fair Value** standard?

Par. 6: Cost Approach is defined (par. 6) as a measurement technique that reflects the amount that would be required currently to replace the service capacity of an asset (often referred to as Current Replacement Cost). We find the term 'Cost Approach' misleading because it can be confused with the historical cost basis. Why is it not called 'Current Replacement Cost'?

Par. 7 (page 12) refers to IPSAS 33 with regards to initial measurement in an opening statement of financial statements. It should be noted that IPSAS 33 is not obligatory.

Par. 43 states that the Cost Approach reflects the amount that would be required currently to replace the service provided by an asset (often referred to as Current Replacement Cost) through the acquisition, construction, or development of substitute asset of comparable utility, adjusted for obsolescence. The question naturally arises: why is the Cost Approach not called Current Replacement Cost? The latter term is more self-explanatory.

BC.50 (Page 149) states that '*the IPSASB did not propose current operational value be added to any other IPSAS when this [draft] Standard was issued*'. Please check reference to IPSAS 33 Par. 41(b) on Page 110.

The Implementation Guidance is rather generic. We expected more realistic examples from practice that show how a practitioner would refer to the Conceptual Framework, the Measurement Standard, and the applicable IPSAS. The examples would include issues on measurement of assets and liabilities. Moreover, the Implementation Guidance lacks specific examples on the criteria for measurement of assets acquired through non-exchange transactions.

[1] BC.16 also concludes that the measurement of assets held for sale should also be excluded. However, Par. 4 does not include ED 79 in its scope limitations.

Date: 21st October, 2021 Signed on behalf of the persons listed below:

Caroline	Aggestam Pontopiddan	Associate Professor of Accounting	Copenhagen Business School, Denmark
Eugenio	Anessi Pessina	Professor of Public Management	Università Cattolica del Sacro Cuore, Milan, Italy
Natalia	Aversano	Associate Professor of Accounting	University of Salerno, Italy
Yuri	Biondi	Senior Tenured Research Fellow of the CNRS	IRISSO, University Paris Dauphine PSL, France
Marco	Bisogno	Associate Professor of Accounting	University of Salerno, Italy
Isabel	Brusca	Professor of Accounting and Finance	University of Zaragoza, Spain
Eugenio	Caperchione	Professor of Public Management	University of Modena and Reggio Emilia, Italy
Josette	Caruana	Senior Lecturer	Department of Accountancy, University of Malta, Malta
Johan	Christiaens	Professor of Public Sector Accounting and Auditing, CPA	Ghent University, Belgium
Sandra	Cohen	Professor of Accounting	Athens University of Economics and Business, Greece
Giovanna	Dabbicco	Researcher, and Adjunct Assistant Professor	ISTAT - Italian National Institute of Statistics, Italy
Ellen	Haustein	Lecturer and Scientific Researcher of Accounting, Management Control and Auditing	University of Rostock, Germany
Susana	Jorge	Associate Professor of Accounting	University of Coimbra, Portugal
Peter Christoph	Lorson	Professor of Accounting, Management Control and Auditing	University of Rostock, Germany
Francesca	Manes Rossi	Associate Professor of Accounting, CPA	University of Naples Federico II, Italy
Mariafrancesca	Sicilia	Associate Professor of Public Sector Management and Accounting	University of Bergamo, Italy
Ileana	Steccolini	Professor of Accounting and Finance	Essex University, U.K.