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The International Public Sector Accounting Standards Board

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Submission via website

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Dear Ross

COMMENTS ON ED 77 ON IPSAS, *MEASUREMENT*

We welcome the opportunity to provide comments on Exposure Draft (ED) 77 of the proposed IPSAS, *Measurement*

General

We issued ED 77 for comment in our jurisdiction. We arranged a series of education sessions and roundtable discussions to solicit views from preparers, auditors, technical experts, academics, consultants, professional bodies and users. Members of the Pan African Federation of Accountants also attended these sessions.

The comments outlined in this response have been developed by the Secretariat of the ASB and not the Board.

Overall impressions of ED 77

We support the IPSASB's project on measurement as it will provide consistent guidance on measurement. Overall we support the proposals in ED 77.

Introduction of public sector specific measurement basis

We share the same concerns raised in the Alternative Views expressed in ED 76 and ED 77.

Consistent with our response to ED 76, we do not support the introduction of the current operational value (COV) in the Conceptual Framework and the related guidance in this ED. Our understanding of the development of this public sector specific measurement basis was to address concerns raised in the CP, that replacement cost cannot be used as a measurement basis as well as a measurement technique. We believe that a simpler approach to resolve this

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conflict is not to introduce a new measurement basis but to retain replacement cost as a measurement basis and remove the cost approach as a possible technique in ED 77.

Use of the income approach to estimate COV

Consistent with the Alternative Views, we do not support the use of the income approach to estimate COV for operational assets. We do however believe that there may be merit in considering the measurement technique when assets are held for both operational and financial capacity.

Disclosures

We agree with the IPSASB's decision to base the disclosure requirements for current value measurement bases on the IFRS 13 disclosures. While we support the disclosures included in IPSAS, we are concerned that the requirements may be applied with no consideration of materiality resulting in disclosure overload in the financial statements. We urge the IPSASB to encourage stakeholders to assess materiality when considering the level of detail, aggregation and disaggregation of the information required by the disclosures.

Our detailed comments on ED 77 are set out as follows:

- Annexure A – Responses to specific matters for comment
- Annexure B – Other significant issues

If you have any questions regarding our responses, please feel free to contact me.

Yours sincerely



Jeanine Poggiolini
Technical Director

ANNEXURE A – RESPONSES TO SPECIFIC MATTERS FOR COMMENT

Specific Matter for Comment 1:

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.

We agree with the principle established for initial recognition.

Specific Matter for Comment 2:

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 agree that an accounting policy choice should be made to measure an item at its historical cost or current value.

Our stakeholders noted that guidance is needed on the acceptable methodologies for measuring current values when market-based evidence is not readily available. The guidance will ensure that current values are not manipulated as a means to improve the values presented in the statement of financial position.

Specific Matter for Comment 3:

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.

We agree that the guidance in Appendix A is appropriate.

Specific Matter for Comment 4:

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.

We agree that no measurement techniques are required when applying the historical cost basis.

Some of our stakeholders questioned why no measurement techniques were identified for the historical cost measurement basis.

Recommendation

We suggest that the IPSASB explains in the Basis for Conclusions its rationale why no techniques are required for the historical cost.

Specific Matter for Comment 5:

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.

Please refer to our response in SMC 6.

Specific Matter for Comment 6:

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.

We do not support the concept of current operational value (COV) and the proposed definition.

Please consider our detailed response to SMC 3 in ED 76.

Our comments on the accompanying guidance are provided below.

General

Our stakeholders found it difficult to understand the objective of the measurement basis and how it is determined. In the absence of illustrative guidance, it was unclear how different the values will be of assets measured using COV versus existing measurement bases.

The value of an asset

As noted in our response to ED 76, it is unclear whether COV measures the value of an asset that is used for service delivery or the cost required to replace the service potential of an asset. It is also unclear what the value determined under COV would represent.

Entity specific value

ED 77 explains that the measurement objective of COV is that it is an entry price. Our stakeholders agreed with the observation in AV14 that if COV is intended to be an entry price (i.e., the price paid to acquire an asset) then allowing the use of the income approach (i.e. cash

flows generated by the asset) results in an exit value. Therefore, the income approach to measure COV is inconsistent with the intended measurement objective of the measurement basis.

Other stakeholders questioned why an asset's value needs to be entity-specific. In their view, when two entities use the same asset to provide the same service then the value of the asset should be the same.

Surplus capacity

Paragraphs B10 to B12 explain that COV assumes that the asset is used to its full capacity, subject to tests for impairment in accordance with IPSAS 21 on *Impairment of Non-cash-generating Assets* or IPSAS 26 on *Impairment of Cash-generating Assets*. Surplus capacity exists when an asset is not used to its maximum capacity.

We do not agree with the IPSASB's decision that COV should include surplus capacity. We believe that if the premise is that COV reflects the current use of an asset, then surplus capacity should not be included so that the value estimated fairly reflects the entity's current use.

We also note that when the cost approach is applied, COV is estimated by calculating the cost of a modern equivalent asset and deducting adjustments for obsolescence (i.e., physical, functional and economic obsolescence). Paragraph B36(b) explains that economic obsolescence relates to a loss of utility. It is unclear in what circumstances a reduction in capacity is considered surplus capacity or obsolescence as the proposed treatment varies.

Restrictions

Paragraph B14 makes a distinction between restricted assets where an equivalent restricted asset is obtainable in the market and where they are not obtainable.

Paragraph B14(a) states that if an equivalent restricted asset is available, then the asset's COV is measured based on available market evidence for the equivalent restricted asset, without any further reduction for the restrictions.

Paragraph B14(b) sets a principle that if the entity's asset is subject to restrictions but there is no equivalent restricted asset in the market, then COV is estimated based on the value of an equivalent unrestricted asset without a reduction for restrictions. Paragraph B16(b) further explains that the equivalent unrestricted asset would be an asset with the same characteristics as the entity's asset being measured but it is not subject to all restrictions imposed on the entity's asset.

The rationale for the above requirement is set out in the Basis for Conclusions (BC43 to BC 44). Given the change in treatment from existing requirements, it might be useful to provide this reasoning in the guidance. In addition, since the asset could be under or over valued when the COV has not been adjusted for the entity's restrictions, the IPSAB should consider if additional disclosures should not be provided.

Recommendation

In line with our recommendations in ED 76, we recommend that the IPSASB does not introduce COV as a measurement basis. This will mean that:

- Replacement cost is retained as a measurement basis in the Conceptual Framework.

- Replacement cost is applied as an alternative measurement basis to fair value. It is applied to measure operational assets as the IPSASB intended with COV.
- Cost approach is removed as a possible measurement technique in ED 77. As a result, fair value can only be measured using the market or income approach. We do not believe that a separate measurement technique is required to determine replacement cost. Thus like historical cost, no technique will be identified for replacement cost.

Alternatively, should the IPSASB retain the proposed COV, we suggest that additional guidance is provided to clarify the matters raised in our response.

Specific Matter for Comment 7:

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.

Notwithstanding our earlier responses, we agree with the assumption that the equivalent asset should be in the same location as the asset being measured.

Specific Matter for Comment 8:

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.

Notwithstanding our earlier responses, we partially agree that the income approach is applicable to estimate the value of an asset measured using COV.

Consistent with the Alternative View, we do not support the use of the income approach when assets are held for their operational capacity. We believe that when assets generate cash flows or revenue and expenses, the value of the asset measured using COV would vary significantly from the value attained using the market approach or cost approach, and would not be a faithful representation of the remaining service potential of the entity's asset.

However, we do believe that there may be a case to permit the use of the income approach when estimating COV for assets held with a dual measurement objective – i.e., both financial capacity and operational capacity.

Recommendation

If the IPSASB decides that the income approach is still applicable, it may be useful to clarify in what instances the approach cannot be used, for example when the cash flows or revenue and expenses generated from the asset are nominal.

Specific Matter for Comment 9:

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.

We agree with the proposal to align the fair value definition and guidance with IFRS 13.

As a consequence of our recommendation in SMC 3 to retain replacement cost, we recommend the removal of the cost approach as a measurement technique in ED 77.

Specific Matter for Comment 10:

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.

We agree with the guidance on cost of fulfillment.

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, *Measurement*?

If not, please provide your reasons, stating clearly where the measurement disclosure requirements should be included, and why.

We agree that the measurement disclosure requirements should be located in the IPSAS to which the asset or liability pertains.

The disclosure requirements include the same requirements repeated in each IPSAS. We suggest that these are tailored sufficiently for each individual 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.

We are not aware of any measurement disclosure requirements that apply across IPSAS that should be included in ED 77.

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.

Notwithstanding our response in ED 78 on the integration of guidance, we agree in principle that current value disclosure requirements should be the same across IPSAS.

We understand that the IPSASB decided that the IASB's disclosures in IFRS 13 are appropriate, and used them as a basis to develop additional disclosures so that they apply across all IPSAS for current value model measurements. However, we are concerned that the requirements may be applied without considering materiality and result in extensive information in the financial statements. Since the IPSASB has not yet considered the IASB's broader amendments on materiality, entities may not necessarily consider materiality when assessing the level of detail and aggregation or disaggregation necessary to meet the disclosure objective.

Recent developments of the IASB in the Exposure Draft on *Disclosure Requirements in IFRS Standards—A Pilot Approach* indicate that there is a urgent need to amend disclosure requirements relating to IFRS 13. The IASB explains that its proposals are aimed at helping companies and others improve the usefulness of information disclosed so that they focus on material disclosures.

Recommendation

We suggest that the IPSASB monitors the IASB developments relating to the proposed amendments to the IFRS 13 disclosure requirements. In the interim, it may be useful for the IPSASB to issue communication emphasising that materiality should be applied to the disclosure requirements across IPSAS.

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.

We agree with the distinction between recurring and non-recurring remeasurements and that recurring remeasurements require more detailed disclosures than non-recurring remeasurements.

We are concerned about the level of disclosures required where an IPSAS permits both fair value and COV. Given the proposed location of the disclosure requirements outside ED 77, we believe it would be useful if the requirements could be simplified and tailored particularly for the information required when COV has been used. Such simplification could be achieved if separate

requirements are established for COV (i.e., different to fair value requirements) where unobservable inputs are used. It may also be useful to understand the requirements if guidance is added on the input levels in relation to COV.

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.

We agree that to achieve alignment with IFRS 13, the fair value disclosure requirements should include requirements to disclose inputs to the fair value hierarchy.

Please also consider our response to SMC 13 above.

ANNEXURE B – OTHER SIGNIFICANT ISSUES

Initial measurement - non-exchange transactions

We note an inconsistency in the measurement of non-exchange transactions in ED 77 and ED 78:

- ED 78.12 indicates that PPE acquired through a non-exchange transaction should be measured at its deemed cost.
- ED 77 requires deemed cost to be estimated at initial measurement using one of the current value measurement techniques (market, cost or income approach).
- Appendix E of ED 77 (Amendments to other IPSAS) the IPSASB concludes that assets acquired in a non-exchange transaction (and the related revenue) should continue to be measured at fair value.

We believe that there needs to be more consideration about what the IPSASB intends to do with the measurement of non-exchange transactions as this has the potential to result in different accounting treatments for the same transaction (i.e., asset and related revenue). The same consideration is needed between measurement of transactions in ED 78 versus the final revenue Standards in ED 70 and ED 71.

Appendix E – Amendments to other IPSAS

General

We question the completeness of the amendments to other IPSAS. In particular, the IPSASB has proposed amendments in ED 78 to the initial recognition of PPE such that items acquired in a non-exchange transaction are measured initially at deemed cost. In our review of Appendix E, we noted that similar amendments have not been proposed to the other asset-related IPSAS.

We therefore suggest that the IPSASB considers the impact of ED 77 on other IPSAS, and if a decision was made not to amend those IPSAS then the IPSASB's deliberations should be included in the Basis for Conclusions.

Amendments to IPSAS 23

In addition to our response above on non-exchange transactions, it would be useful for the IPSASB to explain its decision as to why an exit value is more appropriate for the measurement of non-exchange transactions. In our view, the appropriate measurement basis should be an entry value rather than exit value.

Amendments to IPSAS 31

We do not agree that fair value should be the only current value measurement basis for measuring intangible assets. The IPSASB should consider including an alternative measurement basis for intangible assets held for operational capacity.