



The  
Treasury

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Contact: B. Richardson  
Telephone: (02) 9228 4832  
Our Reference: T06/01080  
Your Reference:

20 May 2011

Dear Mr Stevenson

**IPSASB Exposure Draft *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity***

Attached is a copy of NSW Treasury's submission to the International Public Sector Accounting Standards Board (IPSASB) in relation to the abovementioned Exposure Draft.

While NSW Treasury supports development of the Exposure Draft by both the IPSASB and International Accounting Standards Board (IASB), we strongly recommend that the IPSASB does not progress the IPSASB Exposure Draft (ED) until the IASB / Financial Accounting Standards Board (FASB) Conceptual Framework Phase D (Reporting entity concept), Phase E (Boundaries of financial reporting, and Presentation and Disclosure) and Phase F (Purpose and status of the framework) are complete. We strongly believe that an ED on the role and scope of the Conceptual Framework and reporting entity concept is best first undertaken by the IASB. The IPSASB should then determine whether there are any not-for-profit specific reasons as to why these conclusions are not appropriate for the public sector.

If you have any queries regarding the attached comments, please contact me on 02 9228 3019 or Barbara Richardson on 02 9228 4832.

Yours sincerely

Robert Williams  
for Acting Secretary



# The Treasury

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Contact: B. Richardson  
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20 May 08

Dear Ms Fox

**IPSASB Exposure Draft Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity**

New South Wales Treasury welcomes the opportunity to provide comments on the above Exposure Draft.

NSW Treasury believes that the IPSASB approach is contrary to long term convergence between the IPSASB and IASB requirements. Our view is consistent with the overall view we expressed on the Consultation Paper on this topic. By having a separate IPSASB project on the Conceptual Framework, the IPSASB risks losing the discipline of rigorously analysing and justifying departures from the IFRS, which is the IPSASB's approach to individual IFRSs. The IPSASB document *Process for Reviewing and Modifying IASB Documents* states that a separate project should only proceed where the public sector issues are so significant that a public sector specific project is justified. From our analysis, we do not believe that is the case for the Framework.

Where there is overlap / duplication between the content of the IPSASB and IASB Framework (e.g. qualitative characteristics), we believe that the original text of the IASB document should be used, wherever possible. Further, where differences between the public and private sector are apparent, these differences could be minimised in the Exposure Draft if the IPSASB adopted the approach of modifying the IASB terminology. For example, by using the term 'resource providers' rather than 'existing and potential investors, lenders and other creditors', the differences between the IPSASB and IASB would be reduced with no loss of meaning.

NSW Treasury also continues to encourage the IPSASB and IASB to work together on not-for-profit entity issues so that their Frameworks are consistent. It is noted that the IASB will be considering the application of the Framework to not-for-profit entities as part of Phase G of its Conceptual Framework project. Therefore, some of the IPSASB issues may be addressed as part of that process.

Detailed comments are attached.

If you have any queries regarding New South Wales Treasury's comments, please do not hesitate to contact me on 612 9228 3019 or Barbara Richardson on 612 9228 4832.

Yours sincerely

Robert Williams  
for Secretary

**IPSASB Exposure Draft *Conceptual Framework for  
General Purpose Financial Reporting by Public Sector Entities:***  
**• Role, Authority and Scope; • Objectives and Users;  
 • Qualitative Characteristics; and • Reporting Entity**

**Specific Matters for Comment**

**1. Role, authority and scope of the Conceptual Framework**

NSW Treasury notes that the IASB has not considered the role, authority and scope of the Framework (Phases E and F of its Conceptual Framework project). The IPSASB should monitor the IASB's progress on these phases closely and should not proceed ahead of the IASB.

*Role of the Conceptual Framework*

1.1 The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) establishes the concepts that underpin general purpose financial reporting (hereafter referred to as financial reporting) by public sector entities that adopt the accrual basis of accounting, other than Government Business Enterprises (GBEs). The International Public Sector Accounting Standards Board (IPSASB) will apply these concepts in developing International Public Sector Accounting Standards (IPSASs) or non-authoritative guidance applicable to the preparation and presentation of general purpose financial reports (GPFRs) of public sector entities.

NSW Treasury does not support the proposed role of the IPSASB Conceptual Framework. We are concerned that the IPSASB Framework project is not simply interpreting the IASB Framework to the public sector, but rather developing a separate public sector conceptual framework to guide the development of future IPSASs. This approach is inconsistent with the transaction neutrality principle. It is different to the approach in many of the existing IPSASs, which are based on IFRS and draw on the IASB's definitions etc underlying the IASB Framework. Consequently, the proposed approach could lead to divergence from, rather than convergence with, IFRS.

*The Authority of the IPSASB Framework*

1.2 This Conceptual Framework does not establish authoritative requirements for financial reporting by public sector entities that adopt IPSASs, nor does it override the requirements of IPSASs. However, it can provide guidance in dealing with financial reporting issues not dealt with by IPSASs or non-authoritative guidance issued by the IPSASB. In these circumstances, preparers and others can refer to and consider the applicability of the definitions, recognition criteria, measurement principles, and other concepts identified in this Conceptual Framework.

NSW Treasury agrees that the proposed IPSASB Conceptual Framework does not establish authoritative requirements and does not override the requirements of IPSASs.

*The Scope of Financial Reporting*

1.6 GPFRs of public sector entities include, but are more comprehensive than, financial statements including their notes. They can report information about the past, present, and the future that is useful to users—including financial and non-financial quantitative and qualitative information about the achievement of financial and service delivery objectives in the current reporting period, and anticipated future service delivery activities and resource needs. GPFRs are likely to comprise multiple reports, each responding more directly to certain aspects of the objectives of financial reporting and matters included within the scope of financial reporting. The format of presentation adopted by GPFRs will also respond to, and be influenced by matters included within, the scope of financial reporting.

First, NSW Treasury does not support the proposed scope of the IPSASB Conceptual Framework. The scope of the Framework is stated to be for "general purpose financial reporting by public sector entities that adopt the accrual basis of accounting, other than Government Business Enterprises (GBEs)" (para 1.1). The exclusion of GBEs reduces the Framework from a framework for the Public Sector to a framework for a section of the Public Sector, that is, the General Government Sector (as that term is used in International Statistical Frameworks).

The Basis for Conclusions BC4.18 states that "The Conceptual Framework does not specify the basis on which financial statements for a group reporting entity are to be prepared ... The IPSASB is of the view that these are also matters that should be dealt with at the standards level". NSW Treasury agrees and therefore asserts that para 1.1 of the exposure draft is contrary to BC4.18 by pre-emptively excluding GBE entities from the Framework scope, when they are theoretically in scope. Further, whilst BC4.21 asserts the potential argument of relevance in centralised or planned economies, that argument does not apply to all or most non-centralised western economies. To state the argument in reverse, GBEs are equally in the scope of the proposed Framework level, unless otherwise determined at the level of accounting standards. The counter argument to BC4.18 is that the scope of Government is the *entire* Government, without exclusions. Therefore, a current section of the Government, e.g. GBEs, should not be excluded.

Importantly, such pre-emptive exclusion at para 1.1 creates a totally unnecessary divergence from the IASB Framework.

Second, NSW Treasury does not support including prospective information and information regarding the achievement of service delivery objectives in financial statements and notes. However, if the IPSASB believes that this type of information should be included in the scope of financial reporting, we believe that the distinction between financial (audited) and non-financial (unaudited) information must be explicitly acknowledged. At present, prospective management information and information about service delivery objectives generally do not form part of the audited financial statements.

When considering the proposed IPSASB scope of financial reporting, there should be consideration of the parameters placed on annual disclosure of such information in the financial statements to ensure they can be faithfully represented, and verifiable (auditable). In addition, the practicability and cost versus benefit of capturing, collating and reporting prospective information and information regarding the achievement of service delivery objectives need to be considered.

#### *Evolution of the Scope of Financial Reporting*

1.5 The scope of financial reporting will evolve in response to users' information needs, consistent with the objectives of financial reporting.

NSW Treasury considers that the IPSASB Framework should state the criteria it plans to use in assessing how the scope of financial reporting should evolve in response to users' information needs.

Further, we believe that, while the concept of what is included in a GPFR will evolve (e.g. the current trend of reporting on sustainability), it is not realistic or desirable for it to ever envisage such reports as providing all information that is useful for accountability and decision making purposes (refer IASB Framework September 2010, paragraph OB6<sup>1</sup>). Therefore, it is preferable to limit any non-financial and prospective information that may form part of a GPFR to information best communicated in financial statements.

## **2. Objectives of financial reporting by public sector entities and the primary users of GPFRs of public sector entities and their information needs**

### *The Objectives of Financial Reporting*

2.1 The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes (hereafter referred to as "useful for accountability and decision-making purposes").

NSW Treasury agrees with the IPSASB ED's view that accountability should feature in the definition or description of the objectives of financial reporting.

<sup>1</sup> "OB6 However, general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need. Those users need to consider pertinent information from other sources, for example, general economic conditions and expectations, political events and political climate and industry and company outlooks."

Also, arguably, accountability should be a separate objective for both public and private sector entities. However, we note that the current version of the IASB Framework (September 2010) no longer includes 'accountability' (or 'stewardship', because the IASB equates 'accountability' with 'stewardship') in its discussion on the objective of general purpose financial reporting. The current IASB Framework Basis for Conclusions discusses at BC1.24-BC1.28 the reasons why the IASB decided to describe what 'stewardship' encapsulates rather than using the actual term. The only relevant reference to what we would refer to as 'accountability' in the current IASB Framework is at the end of paragraph OB4, which states that

'Information about management's discharge of its responsibilities is also useful for decisions by existing investors, lenders and other creditors who have the right to vote on or otherwise influence management's actions'.

NSW Treasury believes that the exposure draft should clarify the link between accountability and decision-making; i.e. discharging accountability is realised by providing information useful for decision-making.

#### *The Primary Users of GPFRs*

2.4 Consequently, GPFRs of public sector entities are developed primarily to respond to the information needs of service recipients and resource providers who do not possess the authority to require a public sector entity to disclose the information they need for accountability and decision-making purposes. The legislature (or similar body) and members of parliament (or a similar representative body) are also primary users of GPFRs when acting in their capacity as representatives of the interests of service recipients and resource providers. Therefore, for the purposes of this Conceptual Framework, the primary users of GPFRs are service recipients and their representatives and resource providers and their representatives.

NSW Treasury believes the primary user group should exclude 'service recipients and their representatives', as we do not believe that the primary purpose of the financial report is to address customer needs (in the public or private sectors). However, there is minimal impact of excluding this group because, in the public sector context, most, if not all, customers are also resource providers, as potential taxpayers.

A possible approach is to identify 'resource providers' as the primary user group, which would represent the public sector equivalent to the IASB's primary user group of 'existing and potential investors, lenders and other creditors'. The advantage of this approach is that it would promote convergence with the IASB's Framework.

#### *Information Needs of the Primary Users of GPFRs*

2.8 For accountability and decision-making purposes, service recipients and their representatives will require information as input to assessments of such matters as whether:

- The entity is using resources economically, efficiently, effectively and as intended, and whether such use is in their interests;
- The range, volume and cost of services provided during the reporting period, and the amounts and sources of their cost recoveries, are appropriate; and
- Current levels of taxes or other charges are sufficient to maintain the volume and quality of services currently provided.

They will also require information about the entity's anticipated future service delivery activities and objectives, and the amounts and sources of cost recoveries necessary to support those activities.

2.10 For accountability and decision-making purposes, resource providers and their representatives will require information as input to assessments of such matters as whether the entity:

- Is achieving the objectives established as the justification for the resources raised during the reporting period;
- Funded current operations from funds raised in the current period from taxpayers or from borrowings or other sources; and
- Is likely to need additional (or less) resources in the future, and the likely sources of those resources.

2.11 Lenders and creditors will require information as input to assessments of the liquidity of the entity and to confirm that the amount and timing of repayment will be as agreed. Donors will require information to support assessments of whether the entity is using resources economically, efficiently, effectively and as intended. They will also need information about the entity's anticipated future service delivery activities and resource needs. In most cases, governments that provide resources to international governmental organizations are dependent on GPFRs of those organizations for information for accountability and decision-making purposes.

NSW Treasury believes that service recipients and their representatives might be interested in information about service delivery objectives (as described in para 2.8), which is generally excluded from the scope of financial (audited) reporting (refer our comments above on the scope of financial reporting). Meanwhile, service recipients are less likely to be interested in financial (audited) information of the reporting entity. Therefore, consistent with our prior comments, we do not consider them to be primary users of GPFRs.

We consider the discussion around the information needs of resource providers and their representatives in paragraphs 2.10 and 2.11 appropriate and sufficient.

### **3. Qualitative characteristics of, and constraints on, information included in GPFRs of public sector entities**

Whether:

- (a) "Faithful representation" rather than "reliability" should be used in the Conceptual Framework to describe the qualitative characteristic that is satisfied when the depiction of an economic or other phenomenon is complete, neutral, and free from material error; and
- (b) Materiality should be classified as a constraint on information that is included in GPFRs or as an entity-specific component of relevance;

#### *The Qualitative Characteristics of Information Included in GPFRs*

3.2 The qualitative characteristics of information included in GPFRs of public sector entities are relevance, faithful representation, understandability, timeliness, comparability, and verifiability.

3.3 Materiality, cost-benefit, and achieving an appropriate balance between the qualitative characteristics are pervasive constraints on information included in GPFRs.

(a) NSW Treasury agrees with the qualitative characteristics, and notes that, with the exception of the omission of the distinction between 'fundamental' and 'enhancing' characteristics, the qualitative characteristics are identical to the IASB Framework. This illustrates that the differences between the public and private sector are not fundamental. Therefore, consistent with the IPSASB document *Process for Reviewing and Modifying IASB Documents*, we believe that the IPSASB text should be consistent with the IASB text (as much as possible), rather than using different words to say, in essence, the same thing.

Consistent with the above view, we believe 'faithful representation' rather than 'reliability' should be used. We do not see any justifiable public sector-specific reason for departure from the IASB.

Further, we do not see a justifiable public sector-specific reason to omit the IASB distinction between 'fundamental' and 'enhancing' characteristics. While commentators may debate the validity of making such a distinction, arguments for it have not differentiated the public sector.

(b) We believe materiality should be treated as an entity-specific aspect of relevance, rather than as a constraint on reporting useful information. Again, we do not see any justifiable public sector-specific reason for departure from the IASB.

#### 4. The basis on which a public sector reporting entity is identified and the circumstances in which an entity should be included in a group reporting entity

##### *Reporting Entity Definition*

4.1 A public sector reporting entity is a government or other public sector organization, program or identifiable activity that prepares general purpose financial reports.

NSW Treasury broadly agrees with the proposed reporting entity definition. However, we note the ED does not use 'control' in terms of defining a single reporting entity. In Australian Accounting Standards, control is incorporated into the definition of an 'entity', as "...the capacity to deploy scarce resources in order to achieve objectives" (SAC 1, para 6).

Without considering control, a 'segment' as currently defined in IAS 8<sup>2</sup> could be considered a reporting entity under the proposed reporting entity definition, even though the segment has no capacity to control or deploy resources (however, we do not regard a 'segment' as a reporting entity). To address this, we believe that the IPSASB should:

- (a) replace 'a government or other public sector organization, program or identifiable activity' with 'an entity' in paragraph 4.1 and then define or describe what constitutes an 'entity', and
- (b) provide more details around indicative factors or characteristics of a reporting entity (e.g. separation of management from economic interest, economic or political importance / influence and financial characteristics) to help clarify the distinction between a 'reporting entity' and a 'segment'.

NSW Treasury also notes that the IASB has delayed its work on the reporting entity phase of its Framework, which could result in differences between the two Frameworks once the IASB publishes its reporting entity document.

##### *Characteristics of a Reporting Entity*

4.2 Consequently, a key characteristic of a reporting entity is the existence of service recipients or resource providers who are dependent on GPFRs for information about the activities of particular governmental organizations, programs or other identifiable activities for accountability or decision-making purposes.

NSW Treasury agrees in principle. However, we suggest changing the reference 'service recipients or resource providers' to 'users' in describing the key characteristic of a reporting entity in paragraph 4.2. We consider the needs of all users (not just primary users) important and relevant in identifying a reporting entity.

##### *Group Reporting Entity*

4.1 .... A public sector group reporting entity comprises two or more separate entities that present GPFRs as if they are a single entity.

4.7 A government frequently has the authority and capacity to direct the activities of one or more entities so as to benefit from the activities of those entities. It may also be exposed to a financial burden or loss that may arise as a result of the activities of entities whose activities it has the authority and capacity to direct. Other public sector reporting entities, including government departments, agencies or programs may also have the authority and capacity to direct the activities of other entities and to benefit and/or be exposed to a financial burden or loss as a result.

<sup>2</sup> Operating segment is defined as follows in AASB 8.A:

"An operating segment is a component of an entity:

- (a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity),
- (b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and
- (c) for which discrete financial information is available."

4.11 A government (or other public sector entity) may possess the authority and capacity to direct the activities of another entity even though it chooses not to exercise that authority. In many cases, it will be clear when a government (or other public sector entity) has the authority and capacity to direct the activities of another entity—for example, it may be specified in the enabling legislation that established the entity, or in formal contractual or other agreements that relate to its operation. Similarly, in the case of GBEs and other entities that adopt a corporate structure, the government (or other public sector entity) may hold a majority shareholding or other equity interest that confers rights to direct the financing and operating policies of that other entity....

NSW Treasury does not support the group reporting entity concept in the exposure draft in its current form.

We question the IPSASB's decision to avoid using the term 'control' when it discusses the composition of a group reporting entity.

We are unclear why the IPSASB has amended the IASB working definition of control by changing the reference to 'reducing the amount or incidence of losses' to a reference to 'financial burden'. We recommend retaining the IASB wording as we do not see any significant difference between exposure to a financial burden (IPSASB) and reducing the incidence of losses (IASB). Again, as much as possible, we would prefer that IPSASB retain IASB terminology whenever there is no public-sector reason to deviate from the IASB Framework.

Further, NSW Treasury is particularly concerned about the pre-emptive exclusion of GBEs from the scope of the Framework (para 1.1). Based on paragraph 4.7 and perhaps 4.11, the IPSASB acknowledged that GBEs are controlled by the whole of Government (or other public sector entity controlled by the Government). This clearly suggests that GBEs should be part of a public sector group reporting entity (e.g. the group reporting entity being the whole of Government or other public sector entity). However, we note that the IPSASB has excluded GBEs without a sound justification. Therefore, we strongly encourage the IPSASB to re-consider the scope of the Framework for the inclusion of GBEs.



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Contact: B. Richardson  
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20 May 2011

Dear Mr Stevenson

**Consultation Paper: Conceptual Framework for General Purpose Financial Reporting  
by Public Sector Entities – Elements and Recognition in Financial Statements**

Attached is a copy of NSW Treasury's submission to the International Public Sector Accounting Standards Board (IPSASB) in relation to the abovementioned Consultation Paper.

While NSW Treasury supports development of the Conceptual Framework by both the IPSASB and International Accounting Standards Board (IASB), we strongly recommend that the IPSASB does not progress the IPSASB Elements and Recognition Consultation Paper (CP) until the IASB / Financial Accounting Standards Board (FASB) Conceptual Framework Phase B (Definitions of elements, recognition and derecognition) is complete. We strongly believe that a CP on the elements and recognition in financial statements is best first undertaken by the IASB. The IPSASB should then determine whether there are any not-for-profit specific reasons as to why these conclusions are not appropriate for the public sector.

If you have any queries regarding the attached comments, please contact me on 02 9228 3019 or Barbara Richardson on 02 9228 4832.

Yours sincerely

Robert Williams  
for Acting Secretary



# The Treasury

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*20 May 11*

Dear Ms Fox

**Consultation Paper: Conceptual Framework for General Purpose Financial Reporting  
by Public Sector Entities – Elements and Recognition in Financial Statements**

New South Wales Treasury welcomes the opportunity to provide comments on the above Consultation Paper.

NSW Treasury believes that the IPSASB approach is contrary to long-term convergence between the IPSASB and International Accounting Standards Board (IASB) requirements. In past submissions, we have stated that, by having a separate IPSASB project on the Conceptual Framework, the IPSASB risks losing the discipline of rigorously analysing and justifying departures from the International Financial Reporting Standards (IFRS) requirements, which is the IPSASB's approach to individual IFRSs. The IPSASB document *Process for Reviewing and Modifying IASB Documents* states that a separate project should only proceed where the public sector issues are so significant that a public sector-specific project is justified. From our analysis, we do not believe that is the case for the Conceptual Framework.

Where there is overlap / duplication between the content of the IPSASB and IASB Framework, we believe that the original text of the IASB document should be used wherever possible. Where differences between the public and private sector are apparent, these differences could be minimised in the Consultation Paper if the IPSASB adopted the approach of modifying the IASB terminology. For example, by using the term 'economic resource' rather than 'economic benefits', the differences between the IPSASB and the IASB terminology would be reduced with no loss of meaning.

We also encourage the IPSASB and the IASB to work together on not-for-profit entity issues to ensure consistency in the Frameworks. The IASB will be considering the application of the Framework to not-for-profit entities as part of Phase G of its Conceptual Framework project. Some of the IPSASB issues may be addressed and resolved as part of that process.

If you have any queries regarding New South Wales Treasury's comments, please contact me on 612 9228 3019 or Barbara Richardson on 612 9228 4832.

Detailed comments on the Consultation Paper are attached.

Yours sincerely

Robert Williams  
for Secretary

## ATTACHMENT

**Specific Matter for Comment 1**

- (a) Should the definition of an asset cover all of the following types of benefits—those in the form of:
- (i) Service potential;
  - (ii) Net cash inflows; and
  - (iii) Unconditional rights to receive resources?
- (b) What term should be used in the definition of an asset:
- (i) Economic benefits and service potential; or
  - (ii) Economic benefits?

(a) NSW Treasury considers the definition of an asset should start with the IASB current working definition (IASB-FASB Conceptual Framework project Phase B – Summary of Decisions Reached to Date):

‘An asset of an entity is a present economic resource to which the entity has a right or other access that others do not have.’

The definition can then be amplified by including any public sector-specific concepts such as service potential, etc. We support paragraph 4.5 of the IASB Framework which states that

‘The definitions ... identify their essential features but do not attempt to specify the criteria.....’

(b) Because the term ‘economic resource’ is used in the proposed IASB definition of an asset, NSW Treasury believes it more appropriate to use the term ‘economic resource’ rather than ‘economic benefits’. If IPSASB continues to use the current term, NSW Treasury prefers (b)(ii) ‘economic benefits’, provided that text following the definition makes it clear that ‘service potential’ in the public sector may replace an economic benefit in the private sector.

**Specific Matter for Comment 2**

- (a) Which approach do you believe should be used to associate an asset with a specific entity:
- (i) Control;
  - (ii) Risks and rewards; or
  - (iii) Access to rights, including the right to restrict or deny others' access to rights?
- (b) Does an entity's enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others' access link a resource to a specific entity?
- (c) Are there additional requirements necessary to establish a link between the entity and an asset?

(a) NSW Treasury prefers approach (i) Control. However, given that the IASB is very likely to adopt a ‘right or other access’ approach, we also would support approach (iii) which is a similar concept to the proposed IASB ‘access to rights or other access that others do not have’.

(b) NSW Treasury believes more than one entity may have such ability over a particular resource. Therefore, such enforceable claim or ability does not necessarily link a resource to a specific entity. We also do not like the term ‘or otherwise regulate’, as regulation does not equate to control and can be misinterpreted.

Also, NSW Treasury notes the concept of ‘enforceable claim’ only arises in the proposed IASB definition of a ‘liability’ (IASB-FASB Conceptual Framework project Phase B – Summary of Decisions Reached to Date). Therefore, it might be confusing to use this concept in defining an asset.

(c) We have not identified any additional requirements. However, we believe any additional requirements that may be proposed by the IASB need to be considered in due course.

**Specific Matter for Comment 3**

Is it sufficient to state that an asset is a "present" resource, or must there be a past event that occurs?

NSW Treasury considers it is sufficient to state that an asset is a 'present' resource, to be consistent with the likely IASB approach. Sometimes it is impractical and costly to identify the associated past event. However, a past event can be an indicator of the existence of a past resource.

**Specific Matter for Comment 4**

Recognition and measurement criteria aside, are public sector entity rights and powers, such as those associated with the power to tax and levy fees, inherent assets of a public sector entity, are they assets only when those powers are exercised, or is there an intermediate event that is more appropriate?

NSW Treasury believes they are assets only when those powers are exercised. There appears to be no substantial difference between uncertainties surrounding such rights and powers and other assets. This approach is also consistent with the IASB deliberations, where the IASB decided to address uncertainty about whether an asset or liability exists as guidance accompanying the definitions.

**Specific Matter for Comment 5**

- (a) Are there any additional characteristics that have not been identified that you believe are essential to the development of an asset definition?  
 (b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of assets?

It is difficult to answer these questions until the IASB deliberations are finalised. Any definition gap between the IASB and the IPSASB can then be identified.

**Specific Matter for Comment 6**

- (a) Should the definition of a liability cover all of the following types of obligations?  
 (i) Obligations to transfer benefits, defined as cash and other assets, and the provision of goods and services in the future.  
 (ii) Unconditional obligations, including unconditional obligations to stand ready to insure against loss (risk protection).  
 (iii) Performance obligations.  
 (iv) Obligations to provide access to or forego future resources.  
 (b) Is the requirement for a settlement date an essential characteristic of a liability?

(a) As with assets above, NSW Treasury believes that the definition of a liability should start with the IASB current working definition (IASB-FASB Conceptual Framework project Phase B --- Summary of Decisions Reached to Date):

'A liability of an entity is a present economic obligation for which the entity is the obligor.'

Then, additional accompanying text would clarify the types of obligations to be included as liabilities. We agree that (a)(i)-(iv) would be included in this additional text.

Again, we believe that the IPSASB's definition should adopt wording consistent with the IASB to the extent possible, unless there is a public sector-specific reason for departure.

(b) NSW Treasury does not consider settlement date an essential characteristic of a liability. Settlement date is also not regarded by the IASB as an essential characteristic of a liability.

**Specific Matter for Comment 7**

- (a) Should the ability to identify a specific party(ies) outside the reporting entity to whom the entity is obligated be considered an essential characteristic in defining a liability, or be part of the supplementary discussion?
- (b) Do you agree that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability?
- (c) Which of the three approaches identified in paragraph 3.28 do you support in determining whether an entity has or has not a realistic alternative to avoid the obligation?

(a) NSW Treasury does not consider such ability an essential characteristic in defining a liability. It could be part of the supplementary discussion that it is not necessary to identify specific parties.

(b) NSW Treasury agrees in principle. However, we need to better understand the IASB proposal and how this underlies the definition. The IASB is describing the obligor as the bearer of an enforceable economic obligation.

(c) NSW Treasury supports option (c). We agree with paragraph 3.36 that non-exchange transactions should not be treated differently from exchange transactions in linking the entity and the obligation.

**Specific Matter for Comment 8**

Is it sufficient to state that a liability is a "present" obligation, or must there be a past event that occurs?

NSW Treasury believes that a past event indicates the existence of a present obligation, but is not essential in establishing the existence of a present obligation. Also, the IASB proposal is likely to refer only to a 'present' obligation.

**Specific Matter for Comment 9**

- (a) Recognition and measurement criteria aside, are public sector entity obligations such as those associated with its duties and responsibilities as a government, perpetual obligations, obligations only when they are enforceable claims, or is there an appropriate intermediate event that is more appropriate?
- (b) Is the enforceability of an obligation an essential characteristic of a liability?
- (c) Should the definition of a liability include an assumption about the role that sovereign power plays, such as by reference to the legal position at the reporting date?

(a) NSW Treasury considers that public sector entity obligations are obligations only when they are enforceable claims.

(b) NSW Treasury believes the enforceability of an obligation is an essential characteristic of a liability. We note that the IASB proposal refers to 'enforceable by legal or equivalent means' in its tentative definition of a liability, although it is not clear what 'equivalent means' are.

(c) NSW Treasury does not see the need for making such an assumption.

**Specific Matter for Comment 10**

- (a) Are there any additional characteristics that have not been identified that you believe are essential to the development of a liability definition?
- (b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of liabilities?

(a) Three essential characteristics proposed by the IASB are, 'present', 'economic obligation' and 'obligor'. 'Obligor' may not be adequately covered by the IPSASB.

(b) No other issue has been identified.

**Specific Matter for Comment 11**

- (a) Should revenues and expenses be determined by identifying which inflows and outflows are "applicable to" the current period (derived from a revenue and expense-led approach), or by changes in net assets, defined as resources and obligations, "during" the current period (derived from an asset and liability-led approach)?
- (b) What arguments do you consider most important in coming to your decision on the preferred approach?

(a) NSW Treasury favours an asset and liability-led approach, which is consistent with the approach taken by the current IASB definition and the revenue recognition project.

- (b) NSW Treasury prefers an asset and liability-led approach for the following reasons:
- This approach is consistent with the IASB approach.
  - 'Deferred outflows' and 'deferred inflows' under the revenue and expense-led approach are economic rather than accounting concepts.
  - The draft definitions of 'deferred outflows' and 'deferred inflows' potentially overlap the definitions of assets and liabilities.
  - Adopting the 'inter-period equity concept' would create a precedent for public policy decisions to determine recognition principles.
  - An asset and liability-led approach gives equal importance to the reporting of financial position and financial performance.

**Specific Matter for Comment 12**

- (a) Should transactions with residual/equity interests be excluded from revenues and expenses?
- (b) Should the definitions of revenue and expense be limited to specific types of activities associated with operations, however described?

(a) NSW Treasury believes transactions with residual / equity interests should be excluded from revenues and expenses.

(b) No, NSW Treasury believes that gains and losses should also be included. Again, we should be consistent with the IASB approach, unless there are public sector-specific reasons to deviate from the IASB approach.

**Specific Matter for Comment 13**

- (a) Are there any additional characteristics that have not been identified that you believe are essential to the development of definitions of revenues and expenses?
- (b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the definitions of revenues and expenses?

No additional characteristic or other issue has been identified.

**Specific Matter for Comment 14**

- (a) Do deferrals need to be identified on the statement of financial position in some way?
- (b) If yes, which approach do you consider the most appropriate? Deferred outflows and deferred inflows should be:
- (i) Defined as separate elements;
  - (ii) Included as sub-components of assets and liabilities; or
  - (iii) Included as sub-components of net assets/net liabilities.
- (c) If defined as separate elements, are the definitions of a deferred outflow and deferred inflow as set out in paragraph 5.8 appropriate and complete?

- (a) We do not think deferrals should be identified on the statement of financial position (see our response to Specific Matter for Comment 11).
- (b) and (c) Not applicable

**Specific Matter for Comment 15**

- (a) Do you consider net assets/net liabilities to be a residual amount, a residual interest, or an ownership interest?
- (b) Should the concept of ownership interests, such as those that relate to minority or non-controlling interests in a GBE, be incorporated in the element definition?
- (c) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of net assets/net liabilities?

(a) NSW Treasury considers net assets / net liabilities to be a residual interest. We do not believe the concept of an ownership interest is applicable to most types of public sector entities. The current IASB definition of equity refers to residual interest. This has not caused any problems to date.

(b) Consistent with response to (a) above, NSW Treasury does not think the concept of ownership interests should be incorporated in the element definition.

(c) No other issue has been identified.

**Specific Matter for Comment 16**

- (a) Should transactions with residual/equity interests be defined as separate elements?
- (b) If defined as separate elements, what characteristics would you consider essential to their definition?

(a) NSW Treasury disagrees with defining transactions with residual / equity interests as separate elements. Assuming net assets / liabilities is a residual interest, it would be inappropriate to separately identify and represent the existence of transactions that impact on that residual interest.

(b) Not applicable.

**Specific Matter for Comment 17**

- (a) Should recognition criteria address evidence uncertainty by requiring evidence thresholds; or by requiring a neutral judgment whether an element exists at the reporting date based on an assessment of all available evidence; or by basing the approach on the measurement attribute?
- (b) If you support the threshold approach or its use in a situational approach, do you agree that there should be a uniform threshold for both assets and liabilities? If so, what should it be? If not, what threshold is reasonable for asset recognition and for liability recognition?

(a) NSW Treasury supports requiring a neutral judgment whether an element exists at the reporting date based on an assessment of all available evidence, to be consistent with the IASB proposals.

(b) Not applicable.

**Specific Matter for Comment 18**

Do you support the use of the same criteria for derecognition as for initial recognition?

Yes, NSW Treasury supports the use of the same criteria for derecognition as for initial recognition. However, we will need to consider IASB's deliberations on this in due course.

**Specific Matter for Comment 19**

Should the recognition criteria be an integral part of the element definitions, or separate and distinct requirements?

NSW Treasury is of the view that recognition criteria should be separate and distinct requirements.



The  
Treasury

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Contact: R. Williams  
Telephone: (612) 9228 3019  
Our Reference:  
Your Reference:

20 May 2011

Dear Ms Fox

**IPSASB Consultation Paper: Conceptual Framework: Measurement of Assets and Liabilities in Financial Statements**

New South Wales Treasury welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board (IPSASB) in relation to the abovementioned Consultation paper. Detailed comments are attached.

While NSW Treasury supports development of the Conceptual Framework by both the IPSASB and International Accounting Standards Board (IASB), we strongly recommend that the IPSASB does not progress the IPSASB Measurement Consultation Paper (CP) until the IASB / Financial Accounting Standards Board (FASB) Conceptual Framework Phase C Measurement is complete. We strongly believe that a CP on the measurement of assets and liabilities is best first undertaken by the IASB. The IPSASB should then determine whether there are any not-for-profit specific reasons as to why these conclusions are not appropriate for the public sector.

We note that "the development of the IPSASB Conceptual Framework is not an IFRS convergence project", but that the IPSASB is "closely monitoring the development of the IASB's Conceptual Framework". However, the reason for not treating this as an IFRS convergence project is not explained or supported. Therefore, we encourage the IPSASB to proceed consistent with its document '*Process for Reviewing and Modifying IASB Documents*' (October 2008).

NSW Treasury believes that the IPSASB should work closely with the IASB with the objective of maximising convergence between the two Frameworks and the Accounting Standards. To do otherwise will invariably increase the risk of creating a wedge between the two Frameworks and resulting accounting standards, that will become increasingly difficult to reduce and even more difficult to eliminate.

Further, we believe that maximum convergence between the IPSASB and IASB is in the interests of the integrity of the accounting profession and the usefulness of its accounting standards in the global economy. Any action that increases the risk of unnecessary divergence should be avoided.

NSW Treasury is also concerned that the CP Executive Summary envisages "that the IPSASB Framework will identify factors that should be considered in choosing the measurement basis to be required for *particular* assets and liabilities in specific circumstances" (italics added) (para 1.5). The CP does not adequately explain or demonstrate why the IPSASB reached this conclusion rather than trying to identify a single measurement basis that is appropriate in all circumstances. Instead, the CP signals to a reader that the conclusion will be argued for, instead of rigorously evaluating the alternatives. It also presumes that a mixed measurement will continue.

We believe that the objective of a Framework document should be to conclude on a single measurement basis, even if this is only as an ideal that can only be achieved in certain circumstances, for example, where there is an active market. This can be attempted by critically evaluating each alternative measurement basis against the objectives of financial reporting and the qualitative criteria for information to be useful for decision-making. In this regard, NSW Treasury is concerned that even if the limited scope of the CP is accepted (i.e. based on measurement for particular assets / liabilities), the CP does not critically evaluate each measurement basis, in a structured and rigorous manner. Therefore, we do not believe that the CP is sufficient to satisfy its stated objective.

In addition, we note that the concept of capital is mentioned and linked to measurement bases. However, the concept of capital is not fully explained as being a driver of measurement bases, which therefore undermines the likelihood of reaching a valid conclusion on a desirable measurement basis.

Finally, in NSW Treasury's view, we believe that the CP is difficult to follow, as it mixes terminologies and confuses features, measurement bases, valuation techniques and proxies (e.g. market value versus fair value; replacement cost vs market value). Given this, we do not believe that the CP can reach valid conclusions.

These overarching comments are repeated in the following responses to the specific matters for comment as relevant to each question asked.

If you have any queries regarding the above and the attached comments, please contact me on +612 9228 3019.

Yours faithfully



Robert Williams  
for Acting Secretary

**IPSASB Consultation Paper: Conceptual Framework:  
Measurement of Assets and Liabilities in Financial Statements  
NSW Treasury comments**

*Specific Matter for Comment 1*

*Should the role of the Framework be to identify factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances, rather than specify a single measurement basis or combination of bases?*

As discussed in the covering letter, NSW Treasury has serious concerns that the CP Executive Summary envisages "that the IPSASB Framework will identify factors that should be considered in choosing the measurement basis to be required for particular assets and liabilities in specific circumstances" (para 1.5). This therefore presumes that mixed measurement will continue. However, no reasoned argument for this vision is demonstrated or explained. Instead, it signals to the reader a conclusion has been made (i.e. to identify factors in choosing the measurement bases for *particular* assets and liabilities), that will be argued for, instead of rigorously evaluating the merits of alternative views.

Conversely, we believe that the objective of a Framework document should be to conclude on a single ideal measurement basis, even if this is an ideal that can only be fully achieved in certain circumstances, for example, in an active market. This can be attempted by critically evaluating each alternative measurement basis against the objectives of financial reporting and the qualitative criteria for information to be useful for decision-making.

The CP very briefly refers to the objective of financial reporting for accountability and decision-making and the qualitative characteristics of information (refer paras 1.15 to 1.18). It then very briefly discusses historical cost, market value and replacement cost. This is followed by a lengthy discussion of deprival value in a separate chapter. We are therefore concerned that the CP does not critically evaluate each measurement basis against the relevant qualitative criteria (which are noted at para 1.18) in a rigorous and structured manner. Therefore, even if the limited scope of the CP is accepted, we do not believe that the draft is sufficient to choose a preferred model.

The fact that, in practice, substitutes or proxies may need to be obtained for a measurement basis (and in individual accounting standards) does not deny that the ideal can be articulated. To simply state that "there is no single measurement basis that is appropriate in all circumstances" (para 1.5) misses the point of a Framework document, which should be conceptual in nature and which should attempt to outline an ideal.

Further, articulating an ideal measurement model in the Framework should not preclude also including guidance that may assist in choosing between measurement bases in specific circumstances, in the absence of being able to apply a single measurement basis. This would at least allow for the development of an improved mixed measurement model, as a precursor to applying an ideal model in all circumstances.

In selecting the ideal measurement basis, we also believe that the IPSASB should start with, or at least include, a rigorous evaluation of the various concepts of capital, which can be seen as the driver of the different measurement bases.

However, as discussed in the covering letter, we nevertheless believe that this analysis is best first undertaken by the IASB. The IPSASB's role should be to determine whether there are any not-for-profit specific reasons as to why these conclusions are not appropriate for the public sector.

NSW Treasury also notes that the CP states that "...it is desirable for the measurement bases used in financial statements to be consistent with those used for statistical purposes" (para 1.2). Further, the IPSASB's 'At a Glance' publication of December 2010, more strongly states that "the IPSASB is committed to minimising divergence from the statistical financial reporting models." We are concerned that the IPSASB makes such statements, without any justification and without similarly stating that it is desirable for the IPSASB measurement bases to be consistent, to the maximum extent possible, with those used by the IASB.

Similarly, we find it concerning that the CP refers to the IVSC definition of market value (refer para 3.2 of the CP), but does not include reference to the definition of fair value in the academic literature and IASB framework and accounting standards.

*Specific Matter for Comment 2*

*If in your view the Framework should specify a measurement basis or combination of bases (or approach in the case of deprival value), which should that be?*

*Single measurement bases*

- (a) Historical cost*
- (b) Market value*
- (c) Replacement cost*

*Combinations of Bases/Approach*

- (d) Deprival value*
- (e) Historical cost and market value*
- (f) Replacement cost and market value*
- (g) Historical cost, replacement cost and market value*

*Others*

- (h) Another measurement basis or combination of bases / approach*

*Please explain why you support a particular measurement basis or combination of measurement bases/ approach and your reasons for rejecting alternatives.*

As stated under Specific Matter for Comment 1, we believe that the objective of a Framework document should be to conclude on a single ideal measurement base, even if this is an ideal that can only be fully achieved in certain circumstances, for example, an active market.

In broad terms, we believe there are two main measurement bases: current value and other than current value. We believe that, ideally, the single measurement base should be based on a current value, because current values are more relevant to evaluating and making economic decisions. Within these two measurement bases, there are a number of different measurement approaches, which may or may not be separate measurement bases in their own right. For example:

- Current value includes current market exit price and current market entry price (referred to as 'fair value' in IFRS 13).
- Other than current value includes adjusted past entry prices (sometimes referred to as historic cost).

From the current value bases, we believe that the ideal should be fair value. Market value or fair value is the most widely discussed / used current value model in the existing Accounting Standards, academic literature and the valuation profession. In this regard, we believe that the CP needs to discuss IFRS 13 *Fair Value Measurement*, which defines 'fair value' as an exit price. IFRS 13 is based on the view that a current entry price and a current exit price will be equal when they relate to the same asset or liability on the same date in the same form in the same market (IFRS13, BC44).

In contrast, however, NSW Treasury is concerned at the disproportionate focus given in the CP to deprival value. We particularly note the assertions in the CP that:

- deprival value "provides a rationale by which a specific basis may be selected as the most relevant in specific circumstances" (para 5.2) and
- deprival value "ensures that appropriate consideration is given to all the qualitative characteristics and the need to obtain an appropriate balance between them" (para 5.3).

In response, we believe that fair value, as articulated in accounting standards, does exactly the same as deprival value.

NSW Treasury believes that, in practice, there is no material difference between deprival value and fair value (or market value), as demonstrated in NSW Treasury's Policy Paper TPP 07-1 (refer extract attached as an Appendix to this submission). Therefore, we strongly question the benefit of the deprival value concept, which we view as merely an additional concept that over-complicates the measurement basis.

Finally, we note that IFRS 13 adopts a different solution to the problem of an ideal versus what is the most relevant basis in specific circumstances. Instead of alternative bases of measurement, it outlines a fair value hierarchy of alternative inputs. We strongly believe that a CP on measurement should acknowledge and rigorously evaluate the IFRS 13 approach to measuring assets and liabilities.

### *Specific Matter for Comment 3*

*The Consultation Paper discusses the following measurement bases: historical cost, market value and replacement cost. It also discusses the deprival value concept which does not describe a single measurement basis, but rather a means by which a basis may be selected that is relevant to the circumstances. Value in use and net selling price are discussed in the context of the deprival value model.*

*In your view, is this discussion complete, balanced and fair? If not, please indicate what in your view is missing or in what respects you consider the discussion does not draw out the strengths and weaknesses of the various bases (or approach in the case of deprival value).*

In NSW Treasury's view, the discussion in the CP on the measurement bases is not complete, balanced or fair, for the following reasons.

***The discussion is not complete in many respects***

First, as discussed in Specific Matter for Comment 1, the CP does not rigorously and critically evaluate each measurement basis against the objectives of financial reporting and qualitative characteristics and cost constraints, in a structured, rigorous and consistent manner. The consequence is that the discussion is not complete.

The incomplete nature of the discussion is illustrated by the IPSASB's rejection of a single measurement basis. The fact that, in practice, substitutes or proxies may need to be obtained for a measurement basis (and in individual accounting standards) does not deny that the ideal can be articulated. To simply state that "there is no single measurement basis that is appropriate in all circumstances" (para 1.5) misses the purpose of a Framework document.

Further, articulating the ideal measurement model in the Framework should not preclude including guidance that may assist in choosing between measurement bases in specific circumstances, in the absence of being able to apply a single measurement basis. However, even if the limited scope of the CP is accepted, we do not believe that the CP is sufficiently complete to choose a preferred basis for measurement (or approach).

Second, the CP does not sufficiently discuss the measurement of liabilities, except as part of deprival value which is not a separate measurement basis. The CP asserts merely that liabilities are unlikely to be measured at market value without adequate justification or explanation (para 3.14).

Third, the CP is not complete, because, although the concept of capital is mentioned and linked to measurement bases, the concept of capital is not fully explained as being both a driver of alternative measurements bases, and as a concept that can be seen as a criterion for choosing between alternative measurement bases.

The CP is also incomplete, as it does not discuss the following:

- The unit of account to be measured; i.e. it does not define what is the asset or liability to be measured, which will affect measurement.
- The valuation premise; i.e. whether the valuation is on a stand alone basis or through use in combination with other assets and liabilities.
- What is the appropriate market; i.e.:
  - Principal market
  - Most advantageous market
  - Wholesale vs Retail market.
- Fair value hierarchy, based on inputs.

***The discussion is not balanced or fair***

First, we believe that the discussion in the CP is not balanced or fair as deprival value is overemphasised. Conversely, the discussion of market value / fair value is very brief, even though it is the more widely accepted valuation methodology, and is materially no different from deprival value (refer Specific Matter for Comment 2). We do not accept that the discussion on deprival value needs more emphasis simply because it is not so well known.

Second, the discussion of deprival value is more an argument of why deprival value is better than the other approaches. It argues and concludes in the first three paragraphs that:

- deprival value is well established in the academic literature (para 5.1)
- deprival value "provides a rationale by which a specific basis may be selected as the most relevant in specific circumstances" (para 5.2) and
- deprival value "ensures that appropriate consideration is given to all the qualitative characteristics and the need to obtain an appropriate balance between them" (para 5.3).

Although the same benefits could equally be argued for fair value, in contrast, the discussion of market value / fair value briefly states that "in an ideal context, market value possesses all of the qualitative characteristics" (para 3.5). The majority of the balance of the brief three pages then questions the usefulness of market value in other than the ideal situation, including more than one page explicitly articulating its limitations. Conversely, the 10 page discussion of deprival value did not address or contemplate any of its limitations.

Instead, we believe that the CP should provide a balanced and fair comparison, including an equivalent evaluation of fair value / market value and other bases.

For illustration, the following approach to determining the appropriate financial reporting valuation method was proposed by Chambers in *'Accounting, Evaluation and Economic Behaviour'* (1966)). He asked the following questions:

- What property is to be measured; e.g. monetary measures based on present selling (exit) prices.
- What is the concept of capital, which he termed 'capital maintenance'
- What should be allowed in real world circumstances where the desired measurement basis cannot be reliably applied?

Chambers then argued that all measurements are only approximations; i.e. which, although suggesting an ideal, then accepts surrogates.

Third, we are concerned that the terminology used in the CP is confusing, as it uses concepts that are not mutually exclusive and mixes measurement bases, features and valuation techniques. The resulting conclusions make the CP neither fair nor balanced. For example:

- Market value (as used in Valuation Standards) is confused with fair value (as used in Accounting Standards).
- Valuation techniques (e.g. replacement cost) are confused with measurement bases (e.g. market value).
- Replacement cost is not necessarily an entity specific measure; i.e. DRC is a measure of fair value under Accounting Standards.
- Replacement cost is a subset of market value / fair value; i.e. replacement cost and market value are not mutually exclusive.
- Deprival value is not a measurement base; rather it is an approach to choose the measurement base.
- The CP refers to the IVSC definition of 'market value' but does not refer to the IFRS 13 definition of 'fair value'.

Fourth, the line of argument in the CP is not balanced as it refers to consistency with Government Finance Statistics (GFS), but does not consider consistency with IASB. No rationale is given as to why GFS is an important consideration in the Framework; nor why the IASB Framework is not. The IPSASB Framework presumably will apply at the whole of government level, sector level, and individual entity level. However, as a macro-economic concept, GFS does not apply at the microeconomic level i.e. the entity level.

*Specific matter for Comment 4*

*In your view, should:*

- (a) The effect of an entity's own credit risk be reflected in the measurement of liabilities at initial recognition; and*
- (b) The effect of changes in own credit risk be reflected when liabilities are subsequently remeasured.*

NSW Treasury believes in principle that, where measurement is based on current values, it is appropriate to include own credit risk, both initially and subsequently. However, where the measurement is not based on current values then it is not appropriate to adjust for own credit risk.

However, this requires clarification as to what is regarded as a current value for a liability and when is it appropriate for it to be used. For example, it may not be possible or appropriate to measure the current value (or 'assumption price') of a liability where:

- the highest and best use is to settle rather than transfer the liability or
- there are no market participants.

In such cases, the settlement or cost of fulfilment may be appropriate; i.e. an entity specific measure which makes no reference to market variables such as profit margins or credit risk.

*Specific matter for comment 5*

*In your view, where assets are not restricted in use and therefore may be sold for an alternative use, should the measurement reported in the statement of financial position reflect:*

- (a) Only the service potential relating to the existing use; or*
- (b) Include the incremental value relating to its possible sale for an alternative use?*

NSW Treasury supports the approach adopted in IFRS 13 based on the concept of 'highest and best use'. That is, current value or fair value is based on the highest and best use; i.e. the use of the asset that is physically possible, legally permissible and financially feasible. This principle is established in accounting standard literature, valuation profession literature and academic literature.

Highest and best use is more consistent with para (b) above (i.e. incremental value relating to possible sale for an alternative use), except that we believe it is more appropriate to reflect the value for the highest and best use as one value, rather than, as para (b) implies, based on two measures, the existing use value plus the incremental for an alternative use. We also note that, the IASB, in issuing IFRS 13, has moved away from the concept of an incremental value, which was originally proposed in their fair value Exposure Draft (ED, para 20 and 21).

## APPENDIX 1

### EXTRACT OF NSW TREASURY POLICY PAPER TPP 07-1 VALUATION OF PHYSICAL NON-CURRENT ASSETS AT FAIR VALUE

#### Comparison of fair value and deprival value

This Appendix compares fair value and deprival value. In the past, deprival value has been adopted by some Public Trading Enterprises, following the *Guidelines on Accounting Policy for Valuation of Assets of Government Trading Enterprises* (October 1994). That document adopted the guidance provided in Statement of Accounting Practice SAP 1 *Current Cost Accounting* regarding measuring replacement cost. This Policy and its pre-AEIFRS predecessor (TPP03-02) require entities to value certain physical non-current assets at replacement cost, effectively also using the guidance provided in SAP 1 *Current Cost Accounting*.

This Appendix notes the major differences between fair value in AASB 116, subject to AASB 136 and deprival value and assesses the practical implications of moving to fair value under this Policy.

Two major differences exist between fair value and deprival value:

- Theoretical difference between fair value and deprival value concepts.
- The use of market value in AASB 116 compared to the use of both market value and net market value in certain circumstances under deprival value.

These two differences are briefly discussed below.

#### 1. Theoretical difference between fair value and deprival value

Fair value is based on market evidence - a willing buyer and seller. In effect, this is the 'exit' or selling price. The best available market evidence is used, but where current market prices cannot be observed, fair value in AASB 116 is measured at depreciated replacement cost, which is a market buying or entry price.

Deprival value is measured by reference to the loss suffered by an entity on being deprived of an asset (an entry price). The valuation is then determined depending on whether the entity would or would not replace the asset. In this sense, it is based on rational management intentions.

The difference between fair value and deprival value is the difference between selling price and buying price. However, where current market prices can be observed for the same or similar asset, market selling price and buying price will be approximately equal.

Conversely, where current market prices cannot be observed, market selling price and market buying price may differ significantly. Most proponents of exit market price allow market buying price to be used as a surrogate for market selling price. In this circumstance, AASB 116 and this Policy require fair value to be measured at depreciated replacement cost, which is a market buying price. AASB 116 does not acknowledge that market buying price is being used as a surrogate for selling price. It acknowledges, however, that this is the best available evidence of fair value where market (selling) prices cannot be observed (AASB 116, para 33).

## 2. Market value versus net market value

Deprival value requires surplus assets (i.e. assets held for sale without replacement) to be valued at net market value. In these circumstances, fair value (per AASB 116) and deprival value would differ by the incremental costs directly attributable to selling the asset.

This difference is largely eliminated by the operation of either AASB 5 *Non-current Assets Held for Sale and Discontinued Operations* or AASB 136 *Impairment of Assets*, as follows.

- "Surplus assets" that meet the definition of "held for sale" in AASB 5 must be valued at the lower of its carrying amount and fair value *less costs to sell*.
- "Surplus assets" that do not meet the AASB 5 "held for sale" definition are subject to the recoverable amount test in AASB 136. The *recoverable amount* is defined as the higher of *net fair value* (i.e. fair value *less costs to sell*) and value in use.

## 3. Conclusion

NSW Treasury's conclusion from the above brief analysis is that there are no material practical differences between fair value and deprival value.