



**Australian Government**  
**Australian Accounting  
Standards Board**

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Level 7, 600 Bourke Street  
MELBOURNE VIC 3000  
**Postal Address**  
PO Box 204  
Collins Street West VIC 8007  
Telephone: (03) 9617 7600  
Facsimile: (03) 9617 7608

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**Agenda Paper 13.5**

**XX** June 2011

Ms Stephenie Fox  
The Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West  
Toronto  
Ontario M5V 3H2  
CANADA

Dear Ms Fox

***IPSASB Consultation Paper Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements***

The Australian Accounting Standards Board (AASB) is pleased to provide its comments on the above named Consultation Paper. In formulating its comments, the AASB considered the views received from Australian constituents.

The AASB supports the International Public Sector Accounting Standards Board's (IPSASB's) development of a conceptual framework for public sector entities as a high priority project.

The AASB disagrees with limiting the role of the Measurement chapter of the IPSASB Framework to identifying factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances. The AASB considers that the primary role of the Measurement chapter of the IPSASB Framework should be to identify a comprehensive and conceptually ideal single model for measurement.

The Consultation Paper's analysis of different measurement bases relies heavily on the extent to which the qualitative characteristics would be met under them. However, the AASB considers that the qualitative characteristics do not provide a sufficient foundation for choosing between measurement bases. It is necessary to first identify the most appropriate concept of capital and concept of capital maintenance. Therefore, the AASB recommends that the ED of the Measurement chapter should include an evaluation of concepts of capital and capital maintenance. Until these aspects are addressed and the AASB conducts due process in respect of them, the AASB is not yet able to provide preferred views regarding the measurement basis or bases that would best meet the objective of general purpose financial reporting by public sector entities.

The AASB's responses to the Specific Matters for Comment in the Consultation Paper are set out in Appendix A (supported by elaboration of comments on one issue in Appendix B).

Other AASB comments on the Consultation Paper are set out in Appendix C.

If you have any queries regarding matters in this submission, please contact me or Jim Paul (jpaul@asb.gov.au).

Yours sincerely,

Kevin Stevenson  
*Chairman and CEO*

## APPENDIX A

### AASB's Response to the Specific Matters for Comment on the CP

#### 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?

#### Role of the Framework

The AASB disagrees with limiting the role of the Measurement chapter of the IPSASB Framework to identifying factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances. The AASB considers that the primary role of the Measurement chapter of the IPSASB Framework should be to identify a comprehensive and conceptually ideal single model for measurement. This applies regardless of whether:

- (a) that model may reasonably be expected to be reflected in IPSAS requirements in the foreseeable future; or
- (b) the chapter also includes conceptual guidance to help the IPSASB make incremental improvements to measurement requirements in IPSASs (which the AASB would support). Unless the IPSASB Framework identifies a conceptually ideal single model for measurement, it seems highly likely that measurement requirements in different IPSASs would reflect consensus-building on a Standard-by-Standard basis, reflecting the changing composition of the IPSASB from time to time and the implicit framework of each IPSASB member. Such an approach is likely to result in *ad hoc* measurement requirements that lack overall coherence.

The AASB observes that measurement requirements in IPSASs (consistently with those in IFRSs) presently lack coherence. For example:

- (a) different assets are measured variously at historical cost (for example, some items of property, plant and equipment), fair value (some investment properties), fair value plus directly attributable transaction costs (some financial assets), fair value less costs to sell (biological assets), and value in use (some impaired assets);
- (b) different liabilities are measured variously at the amounts paid by customers for promised goods and services (liabilities to customers in revenue arrangements) and the estimated cost to the entity of providing promised cash, goods or services (employee benefits and other provisions);
- (c) the treatments of revaluation increases differ between different IPSASs and, similarly, between different IFRSs. Under IPSAS 17/IAS 16 *Property, Plant and Equipment* and IPSAS 31/IAS 38 *Intangible Assets*, revaluation increases are

generally credited directly to equity (i.e., outside the profit or loss/result).<sup>1</sup> This treatment is consistent with adopting an operating capability concept of capital maintenance (see comments below on concepts of capital and of capital maintenance). However, under IPSAS 16/IAS 40 *Investment Property* and IPSAS 27/IAS 41 *Agriculture*, revaluation increases are recognised in profit or loss/result. This treatment is consistent with adopting a nominal dollar concept of capital maintenance. Thus, the differing treatments of revaluation increments in IFRSs reflect a mixture of concepts of capital maintenance.<sup>2</sup>

The measurement bases described in (a) and (b) above differ in respect of whether:

- (a) historical or current prices are used; and
- (b) estimated cash flows reflected in the measurement are those of the entity or those of other market participants.

These examples illustrate the pressing need for a single conceptual measurement model to provide a foundation for developing consistent measurement requirements.

Identifying a single conceptually ideal measurement model would not remove the IPSASB's discretion to develop or retain requirements that differ from that model in individual IPSASs. The AASB considers that there is no harm in signalling the direction in which financial reporting requirements should ultimately evolve while acknowledging that, for cost/benefit or other reasons, various of those requirements will not change at present. Identifying a conceptually ideal measurement model would make the IPSASB's decision making more transparent, because the IPSASB would need to explain its reasons for the decisions it makes in developing or amending individual IPSASs. This would enhance the IPSASB's accountability.

Accordingly, the AASB recommends including in the Executive Summary a comment along the following lines: "The IPSASB Framework chapter on Measurement may be used selectively in individual IPSASs for particular assets and liabilities in specific circumstances. It could also provide the basis for more general reform over time of measurement requirements in IPSASs."

### **Concepts of capital and capital maintenance**

The AASB is strongly of the view that, in order to identify a comprehensive and conceptually ideal single model for measurement, it is necessary to identify a preferred concept of capital (in relation to measuring assets, liabilities and, by deduction, equity/net assets) and a preferred concept of capital maintenance (in relation to measuring the period's financial result).

Any set of financial statements will reflect a concept, or number of concepts, of capital and capital maintenance. The choice is whether to explicitly identify a particular concept of

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<sup>1</sup> This treatment applies unless the revaluation increase reverses a revaluation decrease for the same asset (or same class of assets) previously recognised in profit or loss/result.

<sup>2</sup> This discussion of the treatment of revaluation increases is not meant to imply a view about the merits or otherwise at a Standards level of the current distinction between profit/result and other comprehensive income.

capital and a particular concept of capital maintenance, or for a mixture of contradictory concepts to be implicitly embedded in the measures of the financial statement elements.

Applying a mixed measurement model causes different financial statement elements to reflect different economic concepts of value. Consequently, the resulting measures cannot meaningfully be added or validly compared. To illustrate: the sum of the historical cost of an item of equipment and the current net market selling price of a parcel of land has no economic meaning, because different measurement scales are applied to the two assets.

Further details of the AASB’s view and an explanation of the importance of identifying and considering concepts of capital and capital maintenance are presented in Appendix B to this submission.

### **Other comment**

The AASB recommends assuming in the IPSASB’s ED of a Measurement chapter that historical cost and current value are materially different. This is because the purpose of the Measurement chapter should be to provide conceptual guidance for identifying a conceptually ideal single model for measurement, regardless of whether that model is required (in part or in full) in IPSASs. The Executive Summary to the CP says historical cost “may ... not be as relevant as other measurement bases, *particularly* where price changes are significant” (emphasis added). The implication of this statement that, in practice, historical cost and current value may in some cases be materially the same detracts from the importance of identifying the conceptually ideal measurement model (or, at the very least, which measurement attributes are appropriate). Since the purpose of the conceptual analysis in the Measurement chapter should be to help identify which measurement concepts should be preferred to others when they give rise to different amounts, there seems little point in acknowledging that in some cases historical cost and current value may be similar.

#### **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

##### *Combination 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.

At this stage, the AASB does not propose a particular preferred measurement model or basis. A decision about that issue requires extensive due process by the AASB. In addition, the AASB considers that preferred concepts of capital and capital maintenance should guide the selection of measurement bases. In order to make conclusions about measurement bases, the AASB first needs the IPSASB to analyse and make recommendations about concepts of capital and capital maintenance.

**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).

The AASB considers the CP's discussion of measurement bases is incomplete in three respects:

- (a) as noted in the comments on Specific Matter for Comment 1, and most significantly, it does not base the evaluation of measurement bases on an analysis of concepts of capital; and
- (b) it does evaluate fair value as a possible measurement basis, although fair value is widely used in IFRSs and IPSASs. The AASB recommends that the ED of the Measurement chapter of the IPSASB Framework evaluates fair value as a measurement basis. The AASB was not convinced by the reason given in paragraph 1.14 of the CP for not evaluating fair value, because IFRS 13 *Fair Value Measurement* is not the vehicle in which the IASB intends evaluating fair value as a concept; and
- (c) its coverage of liability measurement is inadequate, except in relation to the relief value of liabilities.

In addition, the AASB considers that the ED of the Measurement chapter of the IPSASB Framework should address the unit of measurement; that is, whether the change in the purchasing power of the monetary unit is a phenomenon that should be accounted for. The answer to this question depends, in part, on the concepts of capital and capital maintenance adopted.

## Market values

The CP discusses ‘market values’ as a measurement basis (Chapter 3). It does not specifically acknowledge the fundamental difference between market buying prices and market selling prices (see paragraph 3.3). The main problem with focusing on ‘market value’ or ‘current exchange value’ as the price at which buyers and sellers meet is that preparers of financial statements are in either or both positions for an asset or liability (for example, an entity that buys goods from wholesalers and sells the goods and related services at a profit in a retail market). For them, entry and exit values are not the same because they are found in different markets and, depending on the measurement basis, transaction costs are either added to or deducted from the market price.

In addition, some of the analysis of market values implicitly assumes a market value would be an exit or selling price (see paragraphs 3.12 – 3.13) and criticises market values from that standpoint. The discussion in these paragraphs of the limitations of market values for measuring a public sector entity’s specialised assets reflects an implicit assumption that market values are exit prices, because they discuss the price that a potential purchaser would pay. (For example, paragraph 3.13 speaks to a work-around of the exit price principle in the IFRS 13 *Fair Value Measurement*.) If market *buying* prices could qualify as ‘market prices’, there would be no need to make hypothetical assumptions about the characteristics of a potential purchaser (as the counterparty in a sale of the asset by the entity). Therefore, the AASB is not convinced that the description of market value in paragraph 3.3 (as accommodating exit and entry values) is consistent with the discussion in paragraphs 3.10 – 3.13.

Accordingly, the AASB recommends that the ED of the Measurement chapter of the IPSASB Framework should give greater acknowledgement of the differences between market entry prices and market exit prices, and should discuss (based on a preferred concept of capital) which of them is more appropriate.

### **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?

The AASB agrees with the statement in paragraph A3 that the treatment of an entity’s own credit risk should depend on the measurement basis adopted. The AASB considers this is the key point, and that the measurement basis will in turn depend on the concept of capital adopted (see the last paragraph of comments on this Specific Matter for Comment for elaboration). As indicated in the comments on Specific Matter for Comment 1, the AASB has yet to develop a preferred view of the concept of capital and measurement model that should be adopted conceptually.

The AASB considers that the discussion of the treatment of an entity’s own credit risk seems inconsistent. This is because, although paragraph A3 says the treatment should

depend on the measurement basis adopted, the subsequent discussion in Appendix A implies the treatment is independent of the measurement basis adopted. For example:

- (a) paragraph A4 notes an argument that “An entity’s own credit risk is one of the factors that affect the current value of its liabilities, and so the relevance of the amount of the liability is enhanced if it is stated at an amount that reflects the entity’s credit risk.” This argument:
  - (i) seems to be a *non sequitur*, because own credit risk is also initially reflected in the amortised cost of a liability (which is based on fair value on initial recognition); and
  - (ii) seems also to be contradicted by the exclusion of own credit risk from some current value measures, such as current fulfilment cost and the price to transfer a performance obligation to a third party; and
- (b) paragraph A11 notes the argument that “From the perspective of the entity the possibility of its own default is irrelevant, and so an entity’s own credit risk should not be reflected in its financial statements. To do so is inconsistent with the going concern assumption on which financial statements are based.” However, if the measurement basis selected for an entity’s loan liabilities is current exit price, the entity’s own credit risk should be included in its measurement.

The issue of how to treat an entity’s own credit risk in current measures of the entity’s liabilities illustrates the importance of deciding which concepts of capital and capital maintenance to adopt. An IASB staff paper<sup>3</sup> accompanying an IASB DP on the treatment of own credit risk (issued in June 2009<sup>4</sup>) notes the argument of some commentators that a gain from remeasuring a liability due to a decline in the credit quality of the entity’s liabilities does not reflect that future borrowings will be more expensive (paragraph 50). Placing this argument in the context of applying a concept of capital maintenance: some who support measuring the negative value of capital attributable to an entity’s liabilities as the current cost of replacing those liabilities (using the entity’s current borrowing rate) argue that a gain from a decline in the credit quality of an entity’s liabilities would be offset by the increased cash outflows associated with a replacement loan, and therefore that the entity’s capital has not increased.

**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?

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<sup>3</sup> Wayne S Upton Jr, Project Principal, IASB staff paper, *Credit Risk in Liability Measurement*, June 2009.

<sup>4</sup> IASB Discussion Paper DP/2009/2 *Credit Risk in Liability Measurement*.

The AASB considers that the uses of non-financial assets taken into account in measuring those assets should depend on the ideal concept of capital chosen.

For example, if a concept of capital that emphasises financial flexibility (e.g., current cash equivalents) were preferred, the answer to this question should be (b). If the preferred concept of capital were operating capability, the answer would generally be (a).<sup>5</sup>

The AASB does not express an overall conclusion on this issue, because it has yet to form a preferred view of the concepts of capital and capital maintenance that should be adopted.

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<sup>5</sup> Some commentators consider that if an asset could be sold and reinvested in activities producing the same goods and services at a lower cost (under a particular view of ‘optimisation’ of the asset), the surplus value should be included in the measurement of the asset’s depreciated replacement cost. However, the circumstances in which this could occur would be likely to be fairly limited.

## APPENDIX B

### Concepts of Capital and Capital Maintenance

As mentioned in the AASB's comments on Specific Matter for Comment 1 in Appendix A, the AASB is strongly of the view that, in order to identify a comprehensive and conceptually ideal single model for measurement, it is necessary to identify a preferred concept of capital (in relation to measuring assets, liabilities and, by deduction, equity/net assets) and a preferred concept of capital maintenance (in relation to measuring the period's financial result). This is discussed below.

The CP's analysis of different measurement bases relies heavily on the extent to which the qualitative characteristics would be met under each measurement basis. However, the AASB considers that the qualitative characteristics do not of themselves provide a sufficient foundation for choosing between measurement bases. It is necessary to identify the most appropriate concept of capital, based on an assessment of how well applying each concept of capital would satisfy the qualitative characteristics, before considering measurement bases. Therefore, the ED of the Measurement chapter should include an evaluation of concepts of capital.

The CP discusses measurement bases that would be consistent with particular concepts of capital. However, in the CP, the choice of a concept of capital is not a 'driver' for choosing between measurement bases. Also, the CP does not evaluate which concept of capital would be conceptually ideal.

#### *Concept of capital*

In the context of measurement, an entity's 'capital' is another name for an entity's wealth. In choosing a concept of capital, one decides what aspect or measure of wealth (and claims to that wealth) should be portrayed in measures of the entity's assets and liabilities.

A concept of capital determines the basis of measurement that should be applied to assets and liabilities. Examples of concepts of capital discussed in the accounting literature are:

- (a) invested money capital, which includes: for assets, the original dollar amounts invested in them that have yet to be consumed; and for liabilities, the unearned portion of the amounts originally paid by customers for promised goods and services, plus unrepaid amounts of previous borrowings (These amounts comprise the entity's *nominal* money capital; if the concept of capital adopted were the current purchasing power of invested money capital, the amounts of capital originally invested are adjusted for subsequent changes in the general purchasing power of money.);
- (b) current cash equivalents, which includes: for assets, the net amounts for which they could immediately be sold; and for liabilities, the amounts for which they could immediately be redeemed or transferred to another entity (these exit price measures of assets and liabilities would be reported if the measurement objective is to reflect the entity's short-run adaptive capacity); or

- (c) operating capability, which includes: for assets, the amounts the entity would currently need to pay to acquire them (their current cost); and for liabilities, the current cost of the assets the entity expects to consume in providing promised goods and services to customers, plus the present value of outstanding loans discounted at a current borrowing rate (These amounts of assets and liabilities represent their current cost. An entity's operating capability is its ability, at any given time, to carry out its activities at the scale determined by its then-existing resources. Adopting operating capability as the concept of capital takes a longer-run perspective than adopting current cash equivalents as the concept of capital).

Each of these concepts of capital has a different objective and can provide a different picture of the entity's financial position. The choice of a concept of capital should be based on which of them provides the most useful information for decision making (including for assessing accountability). If a particular concept of capital is chosen, each asset and liability should be measured consistently with that concept. Then users of financial statements would have a clear idea of the meaning (significance) of the amounts reported, in respect of each separately disclosed class of elements and also for the financial statements viewed in their entirety. To illustrate: current practice for various public sector entities in some jurisdictions is to regularly revalue their property, plant and equipment while measuring their debts at amortised cost. Taking price changes into account in measuring assets, but not liabilities, impedes an understanding of the significance of the financial statements viewed in their entirety—this would not occur if all elements were measured in accordance with a particular concept of capital.

Choosing a concept of capital provides a basis for identifying which economic phenomena affecting an entity should be taken into account when measuring the entity's financial statement elements. For example, it provides a basis for identifying whether an entity's own credit risk (and changes in that risk) should be taken into account when measuring the entity's liabilities. This is discussed further in the response to Specific Matter for Comment 4.

### ***Concept of capital maintenance***

The concept of capital maintenance determines whether and, if so, how the measure of the opening balance of equity needs to be adjusted before identifying the result for the period. Thus, it determines whether, and the extent to which, changes in the measures of assets and liabilities affect the entity's result.

Some commentators argue that identifying concepts of capital and capital maintenance is unnecessary. They say the key issue is deciding whether to recognise price changes affecting assets and liabilities when those prices change.

However, this is only part of the issue. Consider a for-profit entity example of an oil refining company that holds large volumes of refined oil when the prices of refined oil double within the current period. Say the current cost to buy unrefined crude oil plus the current cost of refining that oil (that is, the sum of market buying prices of the refined oil) jumps from US\$40 to US\$80 per barrel, and that the current selling price of the refined oil jumps from US\$60 to US\$120 per barrel.

Assume it were agreed that the company's stocks of refined oil should be measured at current prices. One still needs to choose which price: the current buying price (US\$80) or the current selling price (US\$120). This decision should be based on the concept of capital adopted. Assume further that one chooses the current market buying price (US\$80).

Then one needs to decide whether the recognised price change of \$US40 per barrel should be treated as revenue or credited directly to equity. This decision should be based on the concept of capital maintenance adopted. For example, under an operating capability concept of capital maintenance, the increase in current cost would be credited directly to equity because it does not represent an increase in the entity's operating capability—it simply reprices the same service potential. Although the increase in current cost of the refined oil coincides with an increase in the current selling price of the refined oil (thus increasing the margin on its historical cost), the company's ability to carry out its activities has not improved. This is because, when the entity sells the refined oil, it needs to replace the refined oil at a correspondingly higher cost. In contrast, under a short-run adaptive capacity (current cash equivalent) concept of capital and nominal dollar concept of capital maintenance, the refined oil would be measured at its current selling price of US\$120 and the increase in its selling price would be recognised in the period result without adjustment for any change in the general purchasing power of the oil's current cash equivalent.

The for-profit entity example above is provided because the accounting literature on measurement tends to focus on for-profit entities. For not-for-profit entities, sales of goods would tend to represent a relatively minor activity. But for them, the issue would still remain that, if they measured assets (such as supplies for use in providing services) at current market buying prices, and those prices increased, should that increase be included in the period result?

***Topical issues with answers dependent on the concept of capital and concept of capital maintenance***

To illustrate the importance of concepts of capital and of capital maintenance to standard setting issues, some topical issues on which the AASB considers the answers depend on the concept of capital and concept of capital maintenance adopted are:

- (a) the treatment of the entity's own credit risk (see comments in Appendix A on Specific Matter for Comment 4);
- (b) whether an asset's service potential should reflect the asset's existing use regardless of whether it is the asset's highest and best use (see comments in Appendix A on Specific Matter for Comment 5); and
- (c) the measurement basis for provisions. IASB ED/2010/1 *Measurement of Liabilities in IAS 37* proposed that, in some circumstances, liabilities within the scope of IAS 37 should be measured at their fulfilment cost, but proposed that such a cost should include a margin on the entity's own costs. Such an approach would mix different concepts of capital, because fulfilment cost is an entity-specific measure and a profit margin on costs reflects how other market participants might price the obligation.

## APPENDIX C

### Other AASB Comments on the CP

#### Executive summary

| Page &<br>(Para.) | Comment  |
|-------------------|--|
| 8 (7)             | The description of replacement cost should point out explicitly that replacement cost is a form of market value, as it is determined from prices in market exchanges (for inputs, from the reporting entity’s perspective). This would be consistent with the comment in paragraph 5.20 that replacement cost refers implicitly to transactions in a market setting. |

#### Other

| Para. | Comment  |
|-------|--|
| 1.2   | This paragraph says it is desirable for the measurement bases used in financial statements to be consistent with those used for statistical purposes. The AASB considers this is too strong a position. The AASB thinks statistical principles should be a consideration in developing Framework principles, without the IPSASB identifying consistency with statistical principles as a desired objective. In this regard, the AASB observes that the IPSASB’s <i>Process for Reviewing and Modifying IASB Documents</i> only treats consistency with statistical bases as a ‘consideration’ in determining whether public sector issues warrant a departure from an IASB document (in Step 1). |
| 1.8   | Although this paragraph mentions ‘concept of capital’ and contrasts that concept with the concept of capital maintenance, it does not describe what a concept of capital is. The AASB strongly recommends including such a description.  |

| Para. | Comment   |
|-------|---|
| 1.9   | <p>The AASB found the discussion in footnote 8 of a “real terms” concept of capital maintenance to be confusing. This is because:</p> <ul style="list-style-type: none"> <li>• the fifth sentence notes that a capital maintenance adjustment that allows for the effect of general price increases “allows shareholders to compare the growth in the business with the change in wealth necessary to maintain their consumption”. In this context, ‘consumption’ is by shareholders, not the entity; and</li> <li>• the sixth (final) sentence says that, in a public sector context, a real terms system permits an evaluation of whether the financial result is such that, if the demands on resource providers are unchanged in real terms, the financial result would be sufficient to maintain an entity’s current pattern of consumption of resources. Unlike the fifth sentence of footnote 8, this sentence refers to the entity’s consumption.</li> </ul> <p>That is, it is confusing that, in the last two sentences of footnote 8, the consumption may either be that of shareholders or that of the reporting entity. In addition, the reference to the shareholders’ consumption in the fifth sentence is confusing, because it is not apparent why one would account for effects of economic phenomena on shareholders rather than on the entity.</p> |
| 1.12  | <p>The fourth sentence says all bases considered in the deprival value model are entity-specific values. The AASB finds this ‘entity-specific’ label unconvincing. Replacement cost is determined on the basis of a market transaction. Net selling price is unambiguously a market-based value rather than an entity-specific value.</p>   |
| 1.17  | <p>The logical implication of the second sentence is that historical costs cannot be representationally faithful if they differ materially from current (or ‘full’) value. The AASB disagrees with that implication, because faithful representation occurs when financial information faithfully represents what it purports to represent (IPSASB Conceptual Framework Exposure Draft 1, paragraph 3.10). As the IASB’s revised Conceptual Framework (2010) says, a representation may be faithful without the information being relevant (paragraph QC16).</p>  |
| 2.10  | <p>This paragraph could be misread as saying historical cost and budgeting go together. However, when budgeting, it would be strange not to estimate <i>future</i> salary and wage rises for a period and the expected <i>future</i> cost of major assets to be acquired. Therefore, the AASB would not suggest implying historical cost is more suited to budgetary comparisons than other measurement bases. One should budget future costs and compare them with future actual costs (which by then are historical costs), with price variance analysis of the differences. One should do that regardless of whether historical cost or any current value-based measurement model is adopted for financial reporting purposes. And it would not matter how much estimating is needed – as budgeting is focused on the planned use of available funds.</p>  |

| Para. | Comment  |
|-------|--|
| 2.12  | This paragraph does not really explain why the historical cost basis reflects a financial concept of capital. It explains a limited notion of capital maintenance. The AASB suggests a fuller explanation.   |
| 3.14  | This paragraph on liabilities and market values seems an inadequate treatment of the issue. Restrictions on the transfer of liabilities occur particularly with some classes of liabilities, but are not a factor for other liabilities.   |
| 5.3   | The first sentence (which says the deprival value model chooses between measurement bases solely on grounds of relevance) seems to be a mere assertion. The AASB suggests explaining the reasons for that claim.   |
| 5.5   | It is unclear why this paragraph seems to say that recoverable amount is, from a deprival value perspective, the “lowest relevant measure of an asset” and that, upon deprival of an asset, the entity would lose at least the asset’s recoverable amount. This apparent message seems inconsistent with the principle that recoverable amount is the maximum amount at which an asset’s deprival value could be measured, as reflected in Figure 1 under paragraph 5.17. The AASB suggests clarifying the point being made here.  |
| 5.16  | The AASB has a similar concern with the second sentence of paragraph 5.16, which says deprival value cannot be lower than recoverable amount. As Figure 1 indicates, deprival value is the <i>lower</i> of replacement cost and recoverable amount.  |
| 5.7   | <p>This paragraph seems to say that, when net selling price is the appropriate measure of recoverable amount, “the value of the remaining in-use service potential is nil”. However, whilst (as the paragraph indicates) value in use includes the disposal value at the end of the asset’s useful life, when net selling price exceeds value in use, this does not necessarily mean the value of remaining service potential is nil. The value in use might include a much lesser net selling price (as the terminal cash flow) than the current net selling price with which value in use is compared, in which case value in use includes service potential in use.</p> <p>When net selling price exceeds value in use, the entire amount of value in use (including ultimate net selling price) is not part of the measurement of the asset’s deprival value. The AASB thinks it would be clearer to just make this point.</p> |
| 5.9   | The second sentence says one way of measuring value in use is as the amount of future cash outflows avoided by continued use of the asset. The AASB questions this notion of value in use because an asset’s replacement cost represents the cash outflows avoided by already possessing an asset. If an asset’s replacement cost were compared with its recoverable amount measured at value in use determined in this manner (for example, where its net selling price is negligible), the recoverable amount test could effectively be set aside. That is because the asset’s value in use could be measured at the same amount as its replacement cost.  |

| Para.       | Comment  |
|-------------|--|
| 5.11        | <p>In relation to so-called ‘non-cash-generating assets’, such as those deployed in providing subsidised or uncharged services, the AASB recommends noting another viewpoint in this paragraph. That viewpoint is that the assessment of value in use should be performed at a very high level of aggregation (in some cases, at an entity level) if part or all of the cash inflows generated by the assets are appropriations or other transfers from government. It would not be representationally faithful to exclude such transfers from calculations of value in use when those transfers are made for the express objective of funding the provision of services. Identifying cash-generating units at a high level would not be unique to the public sector: it is sometimes necessary and appropriate for complex vertically-integrated private sector businesses.</p> |
| 5.16 – 5.21 | <p>Defining an entity’s capital as its operating capacity<sup>6</sup> (or operating capability) should lead to the selection of current cost rather than current replacement cost, <i>per se</i>. This is because the measurement attribute should represent the most economical way in which the asset’s service potential can be replaced, either by replacement with a modern equivalent asset (replacement cost) or by reproduction (reproduction cost). In other words, current cost is the more economical of replacement cost and reproduction cost of the asset’s remaining service potential.</p>   |
| 5.41        | <p>The comment in the third sentence appears to be an unsubstantiated assertion. The AASB suggests reviewing it.</p>   |

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<sup>6</sup> This term is used in paragraph 5.21.

| Para. | Comment   |
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| 5.45  | <p>Without expressing a conclusion on how liabilities should be measured, the AASB has the following concerns with the arguments presented for measuring a liability at assumption price:</p> <ul style="list-style-type: none"> <li>• The last sentence seems to say an assumption price provides a representationally faithful measure of the entity’s obligation to its creditor, but that begs the question of “what is the attribute of the obligation to be measured?” This question can only be answered fundamentally by reference to a concept of capital.</li> <li>• Also in relation to the last sentence, choosing a measurement basis to reflect “the entity’s accountability to its customer for the amount that has been paid” implies measuring the liability at historical transaction price. This objective would seem to preclude remeasuring the liability if the contract becomes ‘onerous’. It also would preclude measuring the obligation at a <i>current</i> assumption price when prices change, i.e., the price the entity would charge a customer to perform its remaining obligations at any point in time.</li> <li>• The logical extension of the second sentence of paragraph 5.45 is that the obligation should be measured at a probability-weighted estimate of the cost of performing and of the cost of compensating the customer if the entity fails to perform. However, measuring the liability at its historical assumption price effectively focuses only on the refund amount. Focusing only on the refund amount (adjusted when additional compensation would be payable for non-performance) is not helpful when measuring partly-performed contracts: see the bullet point below.</li> <li>• An historical assumption price would not cater for partial performance of a contract in some instances. If a contract is partly performed but not to the extent that the refund amount is less than the transaction price (for example, because the customer would also be compensated for the cost of finding an alternative supplier), the liability would not be remeasured despite the part-performance of the obligation. In addition, some advocates of using an assumption price to measure liabilities would focus on the current price at which the reporting entity would be willing to assume its remaining performance obligations to the customer. Under that approach, if the reporting entity has incurred significant costs in obtaining the customer’s entry into the contract (including, for example, providing staff assistance in choosing between a range of available products), the current assumption price might be less than the transaction price (historical assumption price). That is, act of making the sale could be regarded, effectively, as partial performance under the contract (on the argument that selling services do not need to be explicitly identified in a contract since they are performed by the time the customer enters the contract).</li> </ul> <p>These concerns do not mean the AASB disagrees with measuring liabilities at a current assumption price, but, rather, that it does not find the arguments in paragraph 5.45 convincing.</p> |

| Para. | Comment   |
|-------|---|
| 5.47  | <p>This paragraph refers to “serious practical problems in reflecting changes in prices in obligations that are stated at assumption price”, without explaining what those problems are. The AASB suggests adding such an explanation.</p>  |
| A3    | <p>In relation to the third bullet point, the AASB agrees that the <u>cost of fulfilment</u> should be a present value when fulfilment takes an extended period to complete. However, it is not apparent why using a present value necessarily entails incorporating the entity’s own credit risk when measuring fulfilment cost. An entity’s own credit risk seems unrelated to the value of the entity’s resources required to fulfil its obligation. This view of the AASB is consistent with the comment in paragraph 5.37 that “It is questionable whether the cost of fulfilment should reflect the possibility that the entity may default on a liability.”</p> <p>In relation to the fourth bullet point, the AASB thinks an <u>assumption price</u> for a liability would sometimes take into account the entity’s own credit risk, but this would depend on the circumstances. The price the entity would seek to obtain as compensation for assuming the obligation should reflect the estimated value of the resources needed to fulfil the obligation and a margin for bearing the uncertainty associated with the amount of those resources. Neither of these factors is affected by the entity’s own credit risk. However, if the customer were to pay consideration in advance of the entity’s performance (which would always be the case with a loan, where the entity’s ‘performance’ would be making the loan payments), the arm’s-length price for the reporting entity assuming the obligation should take into account (be reduced for) the effects of the entity’s own credit risk. But, where consideration is not paid in advance of the reporting entity’s performance, it is not apparent why the entity’s own credit risk should affect the assumption price.</p> <p>The fourth bullet point also mentions the <u>cost of release</u> from a liability (which, as paragraph 5.23 says, relates to release either by the entity’s creditor [at a cancellation price] or through transferring the liability to a third party). In this regard:</p> <ul style="list-style-type: none"> <li>• An entity’s own credit risk would probably be reflected in the <u>cancellation price</u> of an obligation. If the entity’s creditor agrees to cancel the obligation, it would weigh up the risk of non-payment by the entity against the loss sustained by cancelling the obligation for less than its face value.</li> <li>• It would seem that the entity’s own credit risk should not be taken into account in a <u>transfer to a third party</u>, as the transferee would not reward the entity for any inferior credit standing. Unlike with fair value (based on a <i>hypothetical</i> transfer to an entity of equivalent credit standing), the focus of measuring the transfer price (an actual exit price) is not on the value of the entity’s liability equalling the value of the counterparty’s asset. That is, to determine the price to transfer an obligation to a third</li> </ul> |

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|                    | <p>party, whether a credit enhancement necessarily occurs in a transfer would be a non-issue.<sup>7</sup> A regulator (such as a financial services regulator) may require that transactions to transfer a particular liability can only take place with entities of equivalent or higher credit standing, which in turn would affect the particular liability’s actual exit price. Accordingly, the exit price for a liability should take into account any restrictions on who may participate in the market for the liability.</p> <p>Based on these views, the AASB suggests that the treatment of an entity’s own credit risk when determining the ‘cost of release’ from a liability would depend on the mode of release being considered.</p> |
| <p>B3 –<br/>B4</p> | <p>The discussion of sale prices for an alternative use in paragraphs B3 and B4 implies a higher ‘reliability’ threshold than is required for other measurement attributes, and scepticism about the reliability of such prices. That apparent scepticism could be construed in respect of using market prices in any context, and thus be an inappropriate source of support for historical cost. The AASB suggests a more neutral discussion of the need to obtain adequate market evidence of a sale price for an alternative use.</p>  |
| <p>B4</p>          | <p>The reference to reflecting an alternative use value possibly only “where the entity is planning disposal of the asset” makes entity intentions a determinant of the measurement. However, paragraph 5.20 of the CP stresses that deprival value<sup>8</sup> is not dependent on management intentions. The AASB thinks entity intentions should not of themselves be a determinant of how assets are measured, and suggests amending paragraph B4 for consistency with that principle.</p>   |

<sup>7</sup> The Basis for Conclusions on IFRS 13 *Fair Value Measurement* says “In a fair value measurement, the non-performance risk related to a liability is the same before and after its transfer. Although the IASB acknowledges that such an assumption is unlikely to be realistic for an actual transaction (because in most cases the reporting entity transferor and the market participant transferee are unlikely to have the same credit standing), the IASB concluded that such an assumption was necessary when measuring fair value for the following reasons: ... (c) Those who might hold the entity’s obligation as assets would consider the effect of the entity’s credit risk and other risk factors when pricing those assets.” (paragraph BC94)

<sup>8</sup> Appendix B to the CP is concerned with the measurement of replacement cost, which is also an important component of deprival value.