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TECHNICAL REVIEW

ED 90 – the ripple effect of IPSAS 46 *Measurement*

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ABSTRACT

This article is a technical review of ED 90 (Exposure Draft) issued by the International Public Sector Accounting Standards Board (IPSASB) in 2024 in view of the applicability of IPSAS 46, the new standard on measurement in public sector financial reporting applicable from 1 January 2025. After summarising the requirements of IPSAS 46, the review analyses the ED as to the anticipated effects of these requirements on existing IPSAS. Particular attention is given to the areas that appear problematic, from the questions put forward by the IPSASB itself to the respondents of the ED, and when alternative views are presented on particular issues. Current operational value is coveted as an important measurement basis that fills a gap in the previous valuation methods applicable across the standards. Even though falling under the current value model, it is different from fair value, with the aim of the IPSASB being to target the specific requirements of the financial measurement of public sector assets that lack an active market. However, there are still uncertainties surrounding the applicability of current operational value for standards like IPSAS 31 *Intangible assets* and IPSAS 43 *Leases*. These uncertainties reflect the underlying problem of referring to techniques (such as discounted cash flow techniques) that are popularly used in private sector accounting. The review concludes that the historic cost model remains the more relevant model to be used in public sector accounting. The current value model necessitates the use of estimates which would be questioned in the public sector context. Whatever approach is taken, such estimates are subjective and should not be included as transactions in the accounting system. Only in this way can accountability, transparency and equity be maintained from financial reporting by public sector entities.

Keywords: Measurement models; Measurement bases; Measurement techniques; Market approach; Income approach; Cost approach.

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ED 90 – o efeito cascata da mensuração do IPSAS 46

RESUMO

Este artigo constitui uma análise técnica do ED 90 [Exposure Draft/Projeto de Norma] emitido pelo International Public Sector Accounting Standards Board (IPSASB) em 2024, como resultado da aplicação da IPSAS 46, a nova norma sobre a mensuração no relato financeiro do setor público, aplicável a partir de 1 de janeiro de 2025. Após resumir os requisitos das IPSAS 46, esta análise examina o ED quanto aos efeitos previstos destes requisitos nas outras IPSAS existentes. É dada especial atenção às áreas que se afiguram problemáticas, a partir das questões colocadas pelo próprio IPSASB aos potenciais respondentes ao ED, e quanto à apresentação de pontos de vista alternativos sobre questões específicas. O valor operacional corrente é perspetivado como uma importante base de mensuração que preenche uma lacuna verificada nos anteriores critérios de avaliação aplicáveis à generalidade das normas. Embora se enquadre no modelo de valor corrente, é diferente do justo valor, procurando o IPSASB visar os requisitos específicos da mensuração financeira dos ativos do setor público para os quais não existe um mercado ativo. Contudo, subsistem incertezas quanto à aplicabilidade do valor operacional corrente a normas como a IPSAS 31 *Ativos Intangíveis* e a IPSAS 43 *Locações*. Estas incertezas refletem o problema subjacente ao recurso a técnicas (por exemplo, técnicas de fluxos de caixa descontados) tradicionalmente utilizadas na contabilidade do setor privado. Esta análise conclui que o modelo do custo histórico continua a ser o modelo mais relevante a ser utilizado na contabilidade do setor público. O modelo do valor corrente exige a utilização de estimativas que serão questionáveis no contexto do setor público. Seja qual for a abordagem adotada, tais estimativas são subjetivas e não devem ser incluídas como transações no sistema contabilístico. Só assim é possível manter a prestação de contas responsável (*accountability*), a transparência e a equidade nos relatórios financeiros das entidades do setor público.

Palavras-chave: Modelos de mensuração; Bases de mensuração; Técnicas de mensuração; Abordagem de mercado; Abordagem do rendimento; Abordagem do custo.

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1. Introduction

Measurement of assets and liabilities in public sector financial reporting has always been a highly debated topic, sparking academic research and practitioners' dilemmas (Caruana et al., 2023). Standardising such measurement is a very challenging task for the international standard setting board of the public sector – the IPSASB. The IPSASB attempts to take into consideration the specific requirements of the public sector context; however, it is committed to emulate private sector financial reporting standards and this is what seems to complicate matters (Caruana, 2021; Bisogno et al., 2024).

The IPSASB launched its measurement project in March 2017 mainly to revise the measurement requirements in international public sector accounting standards (IPSAS) at both initial recognition and subsequently; and to provide detailed guidance on the use of certain measurement bases. Three exposure drafts were issued for public consultation. The project was finalized in May 2023 with the publication of IPSAS 46 *Measurement* and the revision of Chapter 7 of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 46 *Measurement* is applicable from 1 January 2025, making it opportune to consider the implications of its requirements on existing standards. Hence the purpose of ED 90 issued in August 2024, with 29 November 2024 as a deadline for the IPSASB to receive comments.

This article is a technical review of ED 90 *Amendments to IPSAS as a result of the Application of IPSAS 46 Measurement*. Therefore, a clear understanding of the requirements of IPSAS 46 *Measurement* is an essential starting point.

2. IPSAS 46 *Measurement*

IPSAS 46 *Measurement* is different from other standards because it does not deal with one area. IPSAS 46 *Measurement* provides more of a conceptual type of guidance on measurement that affects various topics already covered in other standards. Basically, IPSAS 46 *Measurement* establishes a measurement hierarchy based on three levels, namely, measurement models, measurement bases and measurement techniques.

Historical cost and current value are the two measurement models.

Under the historical cost model there is only one measurement basis, namely, historical cost. Historical cost is the consideration given to acquire, construct or develop an asset, at the time the asset is acquired, constructed or developed.

Historical cost could also be assigned to the consideration received to assume an obligation at the time the liability is incurred. Historical cost is an entry, entity-specific value. At least part of the monetary information about an element is derived from the price of the transaction or event that gave rise to that element. It is important to point out that, following initial measurement, the value of the element is not changed to reflect current conditions. In other words, the value of an asset is not increased and the value of a liability is not decreased (in line with the prudence concept). The value of an asset can decrease through depreciation and impairment testing.

On the other hand, there are three measurement bases under the current value model, namely, fair value, cost of fulfilment and current operational value. Each measurement basis can be operationalised by using various measurement techniques based on market, income or cost. The market approach is a measurement technique that uses prices and other relevant information generated by market transactions involving similar assets or liabilities. The income approach is a measurement technique that, through discounting, converts future cash flows (or future revenue and expenses) to a single current amount. The cost approach is a measurement technique that reflects the amount that would be required to replace the current service capacity of an asset – often referred to as the current replacement cost.

Fair value is a measurement basis that can be used for both assets and liabilities, and can be operationalised using either market, cost or income techniques. The definition of fair value is aligned with that in the private sector's IFRS 13 *Fair Value Measurement*. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is an exit, not entity-specific value. The IPSASB does acknowledge that fair value would be very rarely applicable for public sector assets, due to the lack of active markets. But the application of cost or income techniques is not excluded.

Cost of fulfilment is also an exit price, but it is entity specific. It is a measurement basis that can be used for liabilities, and it is calculated through income techniques. Cost of fulfilment is the cost that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner.

Current operational value is a measurement basis that can be used to measure the value of assets using either market or cost techniques. Current operational value measures the value of an asset to the entity, held for its operational capacity, in its existing use, location and current condition. Therefore, current operational value is entity specific. Current use reflects the way an asset is being used by the entity,

reflecting the policy objectives of the entity operating the asset (which would be social rather than commercial purposes). Therefore, this measurement basis is an entry price.

Current operational value is considered the most important outcome of the measurement project, filling a gap in the current definitions of measurement bases that fall under the current value model. The objective of the IPSASB was to develop a measurement basis that captures the unique measurement characteristics of assets held by public sector entities – notably the challenges in applying fair value. Fair value is the foundation of the current value model in IPSAS 46 *Measurement*. Current operational value is different from fair value because (a) it is explicitly an entry price that includes all the costs that would necessarily be paid for the remaining service potential of an asset; (b) it reflects the value of an asset in its existing use (rather than the asset's highest and best use); and (c) it is entity specific, thus reflecting the economic position of the entity. However, IPSAS 46 *Measurement* does not appear to have taken an in-depth consideration of the critique towards the applicability and risky repercussions of using fair values in the public sector context. The following sub-section elaborates on this criticism.

2.1. Historical cost model and the current value model

The literature presents various reasons why the current value model (aka fair value) may not be suitable for the public sector. The current value model centres around the balance sheet, focusing on measuring the reporting entity's net worth at a certain point in time by measuring assets and liabilities at the balance sheet date. Any movements in values are reflected in the entity's reserves, including retained earnings. Such an approach is problematic because the lack of active markets would necessitate more discretion by the preparer, leading to a high degree of subjectivity that undermines reliability of the financial data included in the financial report (Caruana, 2021). The complexity of certain line items included in the statement of financial performance (such as unrealised gains and losses) can detract from understandability and compromise democratic oversight. Furthermore, the extra costs related to frequent valuations would very often exceed the relevant benefits (Ellwood & Newberry, 2016) because the assets are not held for sale anyway (Mautz, 1981). It is important for developments in the accounting framework for public sector entities to take into consideration its social and political implications (Bisogno et al, 2024).

On the other hand, the historical cost model is considered suitable to satisfy the accountability needs of the public sector. It provides a reliable and objective view of financial performance by adhering to the realization principle, whereby revenues are

recognized primarily upon transactions with external parties rather than through increases in values of assets resulting from subjective valuations. Matching expenses with revenues, the historical cost model adopts a flow method of accounting focusing on income (Biondi, 2012; Biondi & Oulasvirta, 2023). There is less emphasis on discretionary representation and more focus on prudence.

In spite of this, there is no commitment to a specific measurement model. Public sector entities can choose between historical cost model and the current value model. IPSAS 46 *Measurement* does provide some guidance on the choice of model, stating that an entity should consider the characteristics of the item being measured, the measurement objective and the monetary information being presented. Historic cost and current operational value are both entry values, while the cost of fulfilment and fair value are both exit prices. Furthermore, the basis for conclusions for ED 90 specify that an item of property, plant and equipment held for its operational capacity should be measured at current operational value; while an item of property, plant and equipment held for its financial capacity should be measured at fair value. But the advice stops there and there is no clear-cut guidance on when one model would be preferable over the other. We shall note in the next sub-section that there is still an element of subjectivity in the guidance on current operational value, even though it is an entry price like historical cost. This means that there is still a risk that accounting policy choices could be manipulated to pursue alternative objectives, undermining transparency and accountability.

2.2. Current Operational Value

Let us delve a bit deeper into current operational value, since it is a new entry in measurement bases, specifically designed for the public sector requirements.

Assets in the public sector are normally held for their operational capacity, that is, to support the public sector entity in its provision of services. Therefore, the application of fair value is often not applicable because, besides the lack of market data, the concept of highest and best use would not apply. Hence, the development of current operational value, for which the cost approach can be used as a measurement technique in the absence of market data.

Under the current operational value, the statement of financial performance would reflect the value of the asset consumed in providing the services at current prices (rather than at historical cost). The statement of financial position would reflect the amount that an entity would incur to acquire its existing assets to be able to continue to achieve its present service delivery objectives (in other words, the amount an entity would pay at the measurement date for the remaining service potential of its existing assets). This sounds rather familiar because it is very similar

to the definition of current replacement cost, which has been used to date in various IPSAS. In fact, the definition of the cost approach in IPSAS 46 *Measurement* does refer to the current replacement cost.

Appendix B of IPSAS 46 *Measurement* elaborates on the current operational value as a measurement basis for non-financial assets. Current operational value is an *estimate* of what the reporting entity would be willing to pay for the remaining service potential of an asset (in the least costly manner), based on conditions at the measurement date regardless of whether that price is directly observable or not. This means that the current operational value would be exact if there is an active market; but otherwise (which would be the norm), an estimate would be required based on the costs to develop or produce the asset using available price information (for example, referring to the cost of each part required to construct a military asset) and adjusted to reflect the age, functionality and condition of the existing asset (that is, taking into consideration physical, functional and economic obsolescence).

As already pointed out, current operational value is entity specific. This means that the reporting entity should not take into consideration alternative uses of the asset, other than that for which it uses the asset. For example, a fire engine should be valued for its purpose to provide civil protection and not as a vehicle used for transport. It should also not reflect the extra costs that may be necessary in the case of an urgent replacement that may arise due to an unforeseeable event.

When it comes to the measurement techniques applicable, B28 refers to both the market approach and the cost approach, stating that "an entity shall use measurement techniques consistent with one or other of those approaches to measure the current operational value". If multiple measurement techniques are used, resulting in a range of values, then the reasonableness of the range is analysed to identify "the most representative value of the remaining service potential of the asset in the circumstances" (B31).

While IPSAS 46 *Measurement* seems to favour the market approach, it does allow the cost approach when no active market for similar or identical assets exists (B35). The standard recognizes the fact that the more specialised the asset is, the less likely is the existence of an active market, and thus the need for the cost approach, that is, the cost to develop or produce an identical or similar asset. Therefore, even the cost approach may require the use of relevant observable inputs for parts of the asset.

Despite the detailed specifications in Appendix B, the use of current operational value raises a deep concern on how it affects intergenerational equity. Its use may result in inflating the reporting entity's current resource needs even when the

reporting entity does not intend to replace the asset in the imminent future, thus placing an unnecessary burden on current taxpayers (Task Force, 2021; EAA PSAC, 2024).

The specific matters for comment raised in ED 90 highlight that the practical application of current operational value can be problematic, especially with regards to inventories, intangible assets and right-of-use assets. Particularly for intangible assets, ED 90 contains an alternative view about the applicability of the concept, highlighting a serious disagreement about it even amongst the IPSASB members. Besides the fact that the concept itself may require some further refinement, more practical guidance is required because that in IPSAS 46 *Measurement* (elaborated on earlier) appears to be confined to the conceptual level. The next sections explore these challenges.

3. Considering the effect of IPSAS 46 on other standards

ED 90 addresses the impact of IPSAS 46 *Measurement* on other standards and also presents an explanation of the IPSASB's conclusion on the non-applicability of current operational value in certain instances.

3.1. Summary of the amendments proposed by ED 90

The amendments proposed by ED 90 are divided in four parts.

The first part of the amendments proposed by ED 90 concern the applicability of current operational value in IPSAS.

In IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors*, an amendment was needed to specify that a change in the measurement model is a change in accounting policy, while a change in the measurement basis is not. The current value model requires accounting estimates. Changes in these estimates are not a policy change. Only the change from the current value model to the historical cost model (or vice versa) is a change in accounting policy. In this standard, the IPSASB also found it necessary to provide a definition of an accounting estimate as a monetary amount in the financial statements subject to measurement uncertainty. The underlying reason for this is due to the fact that the calculation of current operational value would require various estimates; and changes in these estimates would not constitute a change in accounting policy. An accounting policy change only happens when there is a change in the measurement model, that is, a change from the historical cost model to the current value model, and vice versa. A change in the measurement basis does not constitute a change in accounting policy. In a

nutshell, the term "estimates" required clarification because it is expected that the use of estimates in measurement shall increase.

In the case of IPSAS 12 *Inventories*, current operational value is applicable as a measurement basis at initial measurement, for inventories acquired in non-exchange transactions. It is also applicable at subsequent measurement for inventories held for their operational capacity. Currently, IPSAS 12 *Inventories* requires inventories to be measured at the lower of cost and net realisable value. Where inventories are acquired through a non-exchange transaction, their cost shall be measured as their fair value as at the date of acquisition. However, inventories are required to be measured at the lower of cost and current replacement cost where they are held for (a) distribution at no charge or for a nominal charge; (b) consumption in the production process of goods to be distributed at no charge or for a nominal charge; or (c) consumption in the rendering of services at no charge or for a nominal charge. With IPSAS 46 *Measurement*, in such cases, inventories shall be measured at the lower of cost and current operational value.

The same principle now applies for IPSAS 31 *Intangible assets*. Currently, according to IPSAS 31 *Intangible assets*, on satisfying the definition of an intangible asset, an intangible asset, whether purchased or self-created, is recognized if (a) it is probable that the future economic benefits or service potential that are attributable to the asset will flow to the entity; and (b) the cost or fair value of the asset can be measured reliably. Subsequently, intangible assets with definite lives may be accounted for using a cost model or a revaluation model (which is uncommon because it is only permitted if an intangible asset has a quoted market price in an active market). Under the revaluation model, revaluations are carried out regularly. All items of a given class are revalued (unless there is no active market for a particular asset). The purpose of the proposed revisions to IPSAS 31 *Intangible assets* was to introduce current operational value as an alternative measurement basis for fair value in cases when intangible assets are held for their operational capacity.

Two IPSASB members expressed their concern about the proposed changes of ED 90 on IPSAS 31 *Intangible assets*, mainly since the International Accounting Standards Board (IASB) is in the process of revising the requirements for intangibles in private sector accounting. It was suggested to wait for these revisions before moving on with current operational value for intangibles in the public sector. It was highlighted that current operational value was primarily developed for tangible assets and its requirements may prove challenging for intangibles. Furthermore, given that the revaluation of intangible assets held for their operational capacity is not restricted by the "active market" requirement, this may seriously affect the reliability of the measurement of those intangible assets. As it stands, IPSAS 31 *Intangible assets*

allows the reporting entity to revalue an intangible asset at fair value only if an active market exists for the intangible asset primarily being held for its financial capacity. Under the proposed amendments to IPSAS 31 *Intangible assets*, if a public sector entity holds intangible assets for operational capacity and no active market exists, the entity would be permitted to revalue those intangible assets using the cost approach to measure current operational value. This raises concern about the faithful representation of current operational value measurements, especially for internally generated intangible assets, detracting from the usefulness of this data to users. It is noted that the difficulties that exist to determine the cost of internally generated intangible assets at initial recognition will persist on subsequent measurement, due to continuous development and enhancement of the intangible asset.

For IPSAS 46 *Measurement* itself, it was necessary to clarify the application of the principle "least costly manner" when measuring current operational value. A current operational value measure assumes that the amount an entity would pay for the remaining service potential of an asset at the measurement date is the least costly amount for the asset in an orderly transaction (and does not include, for example, any concessionary elements).

ED 90 proposes that current operational value is an applicable subsequent current value measurement basis for right-of-use assets (that is, assets in the scope of IPSAS 43 *Leases*), using either the market approach or the cost approach. The ability to discount cash flows is a concept that is not limited to one measurement technique. The IPSASB's initial decision is based on the fact that the value of right-of-use assets is most commonly estimated by discounting the expected lease payments. However, two different views are presented in the basis for conclusions (BC99). The first view points out that the market approach would require an entity to estimate the current operational value of a right-of-use asset by discounting observable lease payments of an identical or comparable right-of-use asset in an active market. The second view emphasises that the absence of the income approach to convert future amounts to a single current amount results in limited practical application of current operational value to estimate the value of a right-of-use asset at subsequent measurement. Due to this uncertainty, the IPSASB requested specific feedback from ED respondents about this issue.

The second part of the amendments concern IPSAS 21 *Impairment of Non-Cash Generating Assets.* In this standard, the definition of recoverable service amount was updated to refer to "the higher of fair value less costs to sell and current operational value" (in other words, replacing value in use with current operational value). As a consequence, depreciated replacement cost, restoration cost and service units approaches were removed, which is a pity because these methods were very clearly described. They were removed in order to ensure consistency, particularly since

these approaches did not involve risk adjustments and discounting cash flows to a present value. It should be noted that in the IASB's Conceptual Framework (for the private sector), value in use is a measurement basis that reflects entity-specific current expectations about the amount, timing and uncertainty of future cash flows; and current cost is a measurement basis that reflects the current amount that would be paid to acquire an equivalent asset or received to take on an equivalent liability. Current cost is the same as replacement cost. Similarly, in the current IPSAS 21 *Impairment of Non-Cash Generating Assets*, replacement cost is a proxy measure for value in use. It is not clear how current operational value differs from value in use and current cost. In fact, as already stated, IPSAS 46 *Measurement* does acknowledge that, given that the market approach is rarely applicable in the public sector, the cost approach being suggested for current operational value is the same as current replacement cost.

The third part of the amendments replaced "valuation techniques" with "measurement techniques" to be consistent with the terminology introduced in IPSAS 46 *Measurement*. These amendments affected IPSAS 40 *Public Sector Combinations*, IPSAS 41 *Financial Instruments*, IPSAS 45 *Property, Plant and Equipment* and IPSAS 46 *Measurement* itself. The final part of the amendments aimed to enhance the consistency of current value measurement disclosure terminology across IPSAS. These affected IPSAS 16 *Investment Property*, IPSAS 27 *Agriculture*, IPSAS 30 *Financial Instruments: Disclosures*, IPSAS 34 *Separate Financial Statements,* and IPSAS 38 *Disclosure of Interest in Other Entities*. These amendments could be described as cosmetic changes.

3.2. The non-applicability of current operational value

Certain assets, by definition, are not held for their operational capacity, making current operational value automatically redundant. This is the case for investment property (IPSAS 16), Agriculture (IPSAS 27) and financial assets (IPSAS 41 *Financial Instruments*).

Similarly, the IPSASB decided that current operational value is not an applicable measurement basis for assets in the scope of IPSAS 36 *Investments in Associates and Joint Ventures*, because, being an entity-specific valuation, current operational value does not reflect the investor's ability to participate in the financial and operating decisions of the investee.

For service concession arrangements (grantor, IPSAS 32 *Service Concession Arrangements*) and right-of-use assets (IPSAS 43 *Leases*), the IPSASB confirmed that current operational value is an applicable subsequent measurement basis because these assets are held for their operational capacity. However, no adjustments are required in the relative standards because they cross-reference to other standards

for guidance on subsequent measurement, namely IPSAS 45 *Property Plant and Equipment*, IPSAS 31 *Intangible assets* and IPSAS 16 *Investment Property*.

Similarly, no amendments were considered necessary to IPSAS 37 *Joint Arrangements* and IPSAS 40 *Public Sector Combinations* because the measurement requirements of assets within the scope of these two standards are determined by reference to other standards and shall continue to do so.

4. Conclusion

The purpose of ED 90 is to ensure consistency across the standards in the terminology used and in the underlying concepts regarding measurement. ED 90 focuses on current value measurement in specific standards. It suggests the addition of current operational value as an applicable current value measurement basis at initial recognition and subsequent measurement for IPSAS 12 *Inventories* and IPSAS 31 *Intangible assets*. The ED also proposes updating the definition of recoverable service amount in IPSAS 21 *Impairment of Non-Cash Generating Assets*. Even the definition of an accounting estimate in IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* was deemed necessary.

Some existing measurement bases, such as value in use and current replacement cost, were removed to ensure consistency and coherence with public sector particularities. However, the suggestions of ED 90 also raise certain concerns from both conceptual and practical perspectives. In other words, while the use of particular terminology and alignment of measurement requirements appear ideal, certain concepts are still rather vague for the public sector to embrace and label them as the best way forward. There are some problems that could prove rather challenging to overcome in practice.

ED 90 sheds a spotlight on the practical problems that could be encountered when trying to implement the requirements of IPSAS 46 *Measurement*. It is important for the IPSASB to follow the beam on the practical applications so that proper and useful guidance is provided through the ensuing final amendments to the standards.

Guidance is required by practitioners because the proposals in ED 90 appear to exacerbate the problems associated with the current value model and the accountability of public sector entities is not given the appropriate prominence. The persistent problem seems to be caused mainly by the fact that the private sector style of accrual accounting focuses on balance sheet valuations. This requires the consideration of estimated values that are rather subjective. Subjectivity in public sector financial reporting is rather perilous and could open the door to abuse at the

cost of accountability. Perhaps in public sector accounting, only assets and liabilities that have a cost should be captured in the reporting. Any estimates could be disclosed in the notes or in other reports if considered relevant. Estimates are subjective, and risk distorting a true and fair view, at the expense of current generations. It is suggested that, whenever estimates are required, such estimated values are disclosed but not recorded as an entry in the accounting system.

At the end of the day, the actual purpose of IPSAS 46 *Measurement* is not quite clear. Perhaps a thorough revision of Chapter 7 of the Conceptual Framework would have been sufficient to assist both the IPSASB to streamline measurement issues in its standards, and also to serve as practitioners' reference when the requirements of the standards are not so clear. The publication of IPSAS 46 *Measurement* has somewhat complicated the process for practitioners.

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