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November 26, 2024

International Public Sector Accounting Standards Board (IPSASB)
277 Wellington Street West
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Re: Response to Exposure Draft (ED) 90 Amendments to IPSAS As A Result of Applying IPSAS 46, *Measurement*

Thank you for the opportunity to provide input on the IPSASB's Exposure Draft (ED) 90 *Amendments to IPSAS As A Result of Applying IPSAS 46, Measurement.*

We are generally supportive of the proposals outlined in ED 90; however, we question the applicability of Current Operational Value to assets within the scope of IPSAS 31, *Intangible Assets* and IPSAS 43, *Leases.* Our detailed comments are provided below in the responses to the Specific Matters for Comment.

Additionally, we have sent editorial comments for ED 90 to IPSASB staff in a separate letter.

We hope that you find our comments and insights below helpful.

Kind regards,

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Specific Matter for Comment 1

Do you agree that current operational value is an applicable current value measurement basis for assets in the scope of IPSAS 12, *Inventories*, and IPSAS 31, *Intangible Assets*, as proposed in Part 1 of this ED? If you do not agree, please explain your reasoning.

PSAB's Response:

PSAB agrees that current operational value (COV) is an applicable current value measurement basis for assets that are within the scope of IPSAS 12, *Inventories* (IPSAS 12). This is because the application of COV will provide relevant measurement information to users about an entity's inventories that are being held for their operational capacity versus those held for their financial capacity.

PSAB questions the applicability of current operational value as an appropriate subsequent measurement basis for intangible assets, particularly internally generated intangible assets that have been highly customized for an entity's use. If the proposals to IPSAS 31 are retained, however, PSAB suggests the inclusion of clarifying guidance (i.e., illustrative examples/implementation guidance) in the proposed amendments to IPSAS 31 to ensure a consistent understanding of COV and its applicability to intangible assets.

PSAB also notes that the IASB is reviewing IAS 38, *Intangible Assets* (IAS 38) and consequently may comment on the applicability of COV. As a result, since IPSAS 31 is based on IAS 38, it may be beneficial for IPSASB to delay proposed amendments to IPSAS 31, *Intangible Assets* (IPSAS 31) until IPSASB has a better understanding of any specific measurement challenges arising from this review.

The reasons for our comments are provided below:

1. **IPSAS 31 is based on IAS 38, and the IASB has begun a project to update the core principles in IAS 38. Should the IPSASB adopt the updated changes to IAS 38 in the future, these updates may subsequently affect the applicability of COV to Intangible Assets measured under IPSAS 31.**

    - The IASB has initiated a project to modernize IAS 38 given the "increasing importance of intangible assets in today's business models and the new types of intangible assets (for example, cryptocurrencies) and new ways of accessing intangible assets (for example, software as a service (SaaS) arrangements) not envisaged when IAS 38 was developed"[1].

        Specifically, the scope of IASB's IAS 38 project is to review and identify issues with the current definition, measurement, and recognition criteria of intangible assets (core principles)[2]. If identified issues result in changes to core principles that do not pose public-sector challenges in IAS 38, IPSASB's constituents may advocate for similar changes in IPSAS 31 which may affect the applicability of COV to intangible assets. Among the definition, recognition and measurement issues being explored by the IASB[3] are:

        a. Definition of Intangible Assets:

            i. Can IAS 38 cope with new ways to access and use intangible items in ways that faithfully represents the economics of the transactions?

[1] See Staff Paper Agenda 10, pages 7 of 28: *Accounting Standards Advisory Forum Meeting:* International Accounting Standards Board Meeting, July 2024.
[2] See Staff Paper Agenda 12, pages 7 of 28: *Accounting Standards Advisory Forum Meeting:* International Accounting Standards Board Meeting, July 2024
[3] See Staff Paper Agenda 10, pages 16-19 of 28: *Accounting Standards Advisory Forum Meeting:* International Accounting Standards Board Meeting, July 2024.

b. Recognition of Intangible Assets:

   i. Do the properties of intangible assets justify specific recognition criteria for Intangible Assets?

   ii. Should the recognition criteria be updated to reflect new types of intangible items and new ways entities are accessing and using intangible items?

   iii. Should there be a recognition difference between acquired intangible assets and internally generated intangible assets?

c. Measurement of Intangible Assets:

   i. Can the cost of internally generated intangible assets be reliably measured?

   ii. Is fair-value measurement an alternative for intangible assets for which costs cannot be reliably measured?

While the timeline for the completion of IASB's project is not yet known, the nature of the issues being explored are pervasive to IAS 38, and therefore may directly or indirectly affect the application of COV to Intangible Assets under IPSAS 31.

2. **Applying IPSAS 46 guidance for the cost approach to intangible assets is difficult for internally generated intangible assets that have been highly customized and specialized for an entity's specific use and operating context.**

   - IPSAS 46, paragraphs B35-B38, provides that COV should be determined using the cost approach when an active market for similar or identical assets does not exist. This is achieved by estimating the COV of a "modern equivalent asset that provides an existing asset in its existing use, adjusted to reflect the current age, condition, and functionality of the asset held by the entity…using the cost approach continues to require the use of relevant observable inputs of the asset, where the entity would acquire those parts from the market.[4]"

   - In the case of highly customized/specialized intangible assets that are internally generated however, it may be difficult to find a modern-equivalent asset for such assets and/or similar parts in the market given the uniqueness of the intangible asset and its components. In this instance, it is not clear from the proposed amendments how COV can be determined and practically applied. As it is common for highly customized/specialized assets to be developed within the public sector, if the amendments to IPSAS 31 are retained, PSAB strongly recommends providing illustrative examples and/or implementation guidance to help demonstrate how COV can be determined for internally generated intangible assets that are highly customized/specialized in nature. Providing these illustrative examples and/or implementation guidance will help clarify COV application as a subsequent measurement basis for intangible assets.

3. **Per guidance in IPSAS 46, the measurement of a tangible asset's current operational value is affected by the physical location of an asset. This attribute is not always present in an intangible asset which makes the application of COV to intangible assets challenging.**

   - IPSAS 46, *Measurement* (IPSAS 46), paragraph B18, notes that the measurement of an asset's current operational value is affected by three key aspects: the existing asset, its existing use,

[4] See IPSAS 46, Appendix B35-B38.

and its existing location. For the existing location of an asset, IPSAS 46 paragraph B25, further provides that "…COV assumes that the entity will continue to deliver goods and/or services from the same location in which the asset is currently situated or used." It would be difficult to determine an intangible asset's COV based on its physical location since intangible assets inherently lack physical substance. This feature is more applicable to tangible assets rather than intangibles, thus making it difficult to apply paragraph B25.

- Furthermore, as part of its project to revisit IAS 38, the IASB cited academic research noting that intangible assets also have the attribute of being "non-rivalry in use – the property of an intangible asset that allows it to be used simultaneously in different locations and processes."[5] Such an attribute of intangible assets may also create difficulties for entities when attempting to apply the COV guidance in IPSAS 46 paragraphs B25.

  As stated earlier, should the IPSASB decide to retain the COV amendments to IPSAS 31, PSAB suggests the inclusion of illustrative examples and/or implementation guidance that demonstrate the application of COV and its related measurement guidance in IPSAS 46 to intangible assets. Providing this clarity will support a consistent understanding of the applicability of COV to intangible assets to IPSASB's constituents.

Specific Matter for Comment 2

a. Do you agree that current operational value can be applied to the subsequent measurement of right-of-use assets? If you do not agree, please explain your reasoning.

b. If you agree with (a), do you agree that current operational value can be applied using the current guidance in IPSAS 46 (without the income approach as one of its measurement techniques)? If you do not agree please explain your reasoning.

PSAB's Response:

PSAB does not agree that current operational value can be applied to the subsequent measurement of right-of-use (ROU) assets. Further, PSAB does not agree that current operational value (COV) can be applied without the income approach as one of its measurement techniques. The reasons are provided below:

1. **Using COV to subsequently measure the ROU asset is incongruent with its initial measurement basis that uses the income approach to value the ROU asset and its related lease liability (i.e., Cost of Fulfillment Basis). It may also result in Day 2 measurement differences between the ROU asset and its related lease liability.**

   - The ROU asset is an accounting concept developed to measure and recognize an entity's right to access and use (rent) an asset (that is owned by a separate party) for a defined period of time. The underlying property that is being leased is not itself being bought or sold in a market; it is being rented in exchange for a stream of fulfillment cash flows (i.e., the lease liability) over a defined period of time.

   - Accordingly, when an entity enters, or takes over, an existing lease agreement, the transaction is determined based on the remaining lease liability obligation to be fulfilled (i.e.: the lease transaction would not be settled based on the value of the ROU asset). This means that the

[5] See Staff Paper Agenda AP17B *Academic Literature Review* page 17 of 41: International Accounting Standards Board Meeting, April 2024.
The title and authors cited by IASB Staff were: Crouzet, N., Eberly, J.C., Eisfeldt, A.L., and Papanikolaou, D. (2022), 'The Economics of Intangible Capital', Journal of Economic Perspectives, 36 (3), 29-52. Crouzet, Eberly, Eisfeldt, and Papanikolaou (2022).

inherent initial measurement basis of the ROU asset cannot be divorced from the measurement basis of its related lease liability.

- As per IPSAS 43, *Leases* paragraph 25(a), the initial measurement of ROU assets must be calculated in large part with reference to the initial measurement of the lease liability[6]. The measurement of the lease liability in IPSAS 43.27 applies the income approach[7] which is the designated measurement technique for the cost of fulfillment measurement basis as per IPSAS 46, *Measurement*, paragraphs C20 and C23[8]. The income approach, in turn, is fundamentally anchored in the time-value of money concept, as emphasized in IPSAS 46.C41 and C42:

  > "…*Failure to reflect the time value of money would mean that the resulting measurement would not be a faithful representation of the economic burden the liability represents. An entity shall [therefore] determine the estimated outflows of resources by adjusting the estimates of future outflows of resources for the time value of money, using discount rates that reflect the characteristics of the liability."*

  However, as noted in ED 90, BC 60, COV explicitly rejects the income approach as a valid measurement approach since the cost and market approaches are based on current values where the time-value of money has already been considered:

  > *"…..the income approach would not be applied in conjunction with another measurement technique because discounting future cash flows is not necessary given the market approach assumes pricing for the asset is available on the measurement date, and the cost approach assumes the production or development of the asset is immediate."*

- Thus, the application of COV as a subsequent measurement basis for ROU asset is fundamentally incongruent with the initial measurement premise of the ROU asset itself. Specifically, on initial recognition, the most significant component of an ROU asset will be the initial measurement of its related lease liability[9]. Given how integral the income approach is to measuring the initial ROU asset, changing the ROU asset's measurement basis to COV on Day 2 appears incongruent with the underlying premise provided in IPSAS 43 for the measurement of ROU assets.

- Finally, if COV were to be applied as a subsequent measurement basis for ROU assets, Day 2 measurement differences may result. Specifically, by changing to a different measurement basis for the ROU asset on Day 2 (i.e., COV), an immediate, and potentially significant, measurement difference may be generated between the initial ROU asset value (a significant portion of which is based on the cost of fulfillment of the related lease liability) and the ROU asset's Day 2 value

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[6] IPSAS 43.25(a): The cost of the right-of-use asset shall comprise:
- a) The amount of the initial measurement of the lease liability, as described in paragraph 27;
- b) Any lease payments made at or before the commencement date, less any lease incentives received;
- c) Any initial direct costs incurred by the lessees; and
- d) An estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset.

[7] IPSAS 43.27: At the commencement date, a lessee shall measure the lease liability at the present value of the lease payments that are not paid at that date. The lease payments shall be discounted using the interest rate implicit in the lease if that rate a be readily determined. If that rate cannot be readily determined, the lessee shall use the lessee's incremental borrowing rate.

[8] IPSAS 46.C20: The cost of fulfilment, cannot be observed directly in an active market. It is determined using the income measurement technique.
IPSAS 46.C23: Applying the income approach to estimate the cost of fulfillment shall take into account the attributes of the cost of fulfillment measurement basis. This includes:
- (a) Estimates of future cash flows.
- (b) Possible variations in the estimated amount or timing of future cash flows for liability being measured, caused by the uncertainty inherent in the cash flows.
- (c) The time value of money.
- (d) Other factors that impact the value of the liability.

[9] The cost of the right-of-use asset shall compromise:
- (a) The amount of the initial measurement of the lease liability, as described in paragraph 26;
- (b) Any lease payments made at or before the commencement date, less any lease incentives received;
- (c) Any initial direct costs incurred by the lessee; and

An estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the terms and conditions of the lease, unless those costs are incurred to produce inventories. The lessee incurs the obligation for those costs either at the commencement date or as a consequence of having used the underlying asset during a particular period.

which would now be based on COV. It is not clear in the proposed amendments how these measurement differences would be treated.

2. **As currently defined, neither the market approach, nor the cost approach under the COV measurement basis contemplate time-value of money considerations. This makes COV challenging to apply when determining the value of a ROU asset (i.e., a key component of calculating a ROU asset is the determination of the related lease liability, which applies the income approach).**

   - The market approach determines a current asset price where time-value of money considerations have already been factored in. Specifically, ED 90, paragraph BC60, explains that "…discounting future cash flows is not necessary given the market approach assumes pricing for the asset is available on the measurement date." The exclusion of applying discounting under the market approach is further reinforced through IPSAS 46.D31-D32 which provide specific valuation techniques that are permitted under the market approach[10]. Accordingly, a market approach would not be relevant for measuring of the ROU asset as its underlying property is tied to an obligation of future cash flow payments that must be discounted to determine the present value of the lease liability (i.e., the income approach).

   - Further, the market approach requires the existence of an active market with transactions involving identical or similar assets[11]. For a ROU asset whose determination is largely driven by its related lease liability (which in turn is subject to entity-specific factors – e.g.: contract terms, cash flow expectations that the entity must fulfill, the entity's credit risk, etc.), it may be difficult to observe entity-specific market inputs (e.g., similar lease contract terms for a similar underlying asset) as that information may not be disclosed by market participants, and/or may not be directly comparable.

   - Similarly, the cost approach is a *current* replacement cost through acquisition, construction or development of a substitute asset adjusted for obsolescence[12]. In the case of leases, acquisition cost is the most applicable scenario since the entity would have specifically chosen to lease a turnkey asset over other available alternatives. As discussed earlier however, and as noted in ED 90, paragraph BC60, the time value of money is not a relevant consideration to determine current costs under the cost approach either, as current prices have already factored it in. This makes the cost-approach problematic for an ROU asset, where the significant component of the value is based on expected future cash flows that must be discounted using entity specific considerations (i.e., the entity's expected cash outflows are discounted using the implicit rate in the entity's specific contract for the underlying asset).

   - Given the above, PSAB disagrees with the IPSASB's conclusion provided in ED 90, paragraph BC100 that "…the ability to discount cash flows is a concept not limited to one measurement technique…", since the very definitions of the market and cost approaches as provided within IPSAS 46 directly negate the use of the present value mechanism for considering the time value

[10] IPSAS 46.D31 states:
"Measurement techniques consistent with the market approach often use market multiples derived from a set of comparables. Multiples might be in ranges with a different multiple for each comparable. The selection of the appropriate multiple within the range requires judgement, considering qualitative and quantitative factors specific to the measurement."
IPSAS 46. D32 states:
"Measurement techniques consistent with the market approach include matrix pricing. Matrix pricing is a mathematical technique principally to value some types of financial instruments, such as debt securities, without relying exclusively on quoted prices for the specific securities, but rather relying on the securities' relationship to other benchmark quoted securities."
[11] IPSAS 46.42 states:
"The market approach uses prices and other relevant information generated by market transactions involving identical or comparable (i.e.: similar) assets, liabilities or a group of assets and liabilities."
[12] IPSAS 46.43 states:
" The cost approach reflects the amount that would be required currently to replace the service provided by an asset (often referred to as current replacement cost) through the acquisition, construction, or development of a substitute asset of comparable utility, adjusted for obsolescence…"

of money. Stated differently, PSAB's view is that the measurement techniques as currently defined within IPSAS 46 are each independent and mutually exclusive from each other. Accordingly, elements of one measurement technique (i.e.: present value calculations from the income approach) cannot be mixed with the application of any of the other measurement techniques (i.e.: cost approach or market approach) provided within IPSAS 46.

To conclude, PSAB does not believe that COV can be applied to the subsequent measurement of ROU assets, nor does PSAB agree that the COV can be applied to ROU assets without using the income approach.

Specific Matter for Comment 3

Do you agree with the replacement of value in use of a non-cash-generating asset by current operational value in the definition of recoverable service amount in IPSAS 21, *Impairment of Non-Cash Generating Assets*, as proposed in Part 2 of this ED? Recoverable service amount is the higher of a non-cash generating asset's fair value less costs to sell and its current operational value. If you do not agree please explain your reasoning.

PSAB's Response:

PSAB agrees that current operational value should replace value in use in the definition of recoverable service amount in IPSAS 21, *Impairment of Non-Cash Generating Assets* (IPSAS 21) except for assets in the scope of IPSAS 31 *Intangible Assets* and IPSAS 43 *Leases*[13], given the challenges of applying COV to these assets, as discussed earlier in this response. PSAB notes that a key benefit of this amendment is the alignment of measurement guidance for non-cash generating assets in IPSAS 21, with IPSAS 46, and the updated Chapter 7: *Measurement of assets and liabilities in Financial Statements* (Chapter 7) of IPSASB's Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (Conceptual Framework).

Other Items for Consideration

PSAB identified three additional items that may help provide clarity to IPSASB's constituents in the application of COV:

1. **Include a visual or a reference to IPSASB's subsequent measurement framework (provided in IPSAS 46, paragraph 36) within IPSAS 3, *Accounting Policies, Changes in Accounting Estimates & Errors.*** This will have the benefit of providing readers with greater clarity in understanding the differences between measurement models and measurement bases, and the implications of accounting policy changes to each.

2. **Define or include references to the definitions of operational capacity and financial capacity from Chapter 7 of IPSASB's Conceptual Framework in IPSAS 45 *Property, Plant, and Equipment* (IPSAS 45) and in IPSAS 46.** In ED 90, IPSAS 31, paragraphs AG13 - AG15[14] (pg. 24)

[13] Specifically, for right-of-use assets (i.e., leases) that are being held for their operational capacity.

[14] ED 90, IPSAS 31.AG13 states: "The primary objective for which an entity holds an intangible asset is an important consideration when determining the current value measurement basis. An intangible asset held for its:

(a) Operational capacity supports the provision of services in future periods through physical and other resources. This requires information on the value of the intangible asset as it is currently used by the entity. An intangible held with the primary objective of service delivery is held for its operational capacity and is measured at current operational value; and

(b) Financial capacity provides an entity with the means to fund its activities. This requires information on the amount that would be received on the sale of the asset or in the revenue it generates in use. An intangible asset held with the primary objective of generating a financial return is held for its financial capacity and is measured at fair value."

ED 90, IPSAS 31.AG14 states: "In certain instances, an intangible asset may generate a financial return although it is primarily held for service delivery purposes. For example, a formula for a vaccine is primarily used to provide free vaccinations for a country's citizens, and a small amount is used for the vaccination of non-citizens for profit."

clearly define the terms "operational capacity" and "financial capacity" as it relates specifically to intangible assets. Neither of these terms, however, are specifically defined within IPSAS 45, nor IPSAS 46, yet are both used pervasively throughout the standards, as well as throughout ED 90. Since these terms anchor the application of COV versus fair value to the subsequent measurement of assets, including their definitions directly within IPSAS 45 and 46, or by reference to Chapter 7 of the Conceptual Framework, will provide readers with a consistent understanding of the terms and their applicability to the subsequent measurement of assets.

3. **Clarify the treatment of research costs in relation to COV.** As currently written, IPSAS 31 paragraph 76 may be interpreted to permit the recognition of research costs previously expensed if an entity later determines that such costs now have future benefit and therefore now can be considered as part of 'the whole of the asset'. Paragraph 76 states:

> "76. The revaluation model (i.e., current value model) is applied after an asset has been initially recognized at cost. However, if only part of the cost of an intangible asset is recognized as an asset because the asset did not meet the criteria for recognition until part of the way through the process (see paragraph 63), the revaluation model may be applied to the whole of that asset…"

PSAB's review of the recognition and measurement guidance related to research and development costs in IPSAS 31 (i.e., IPSAS 31 paragraphs 52, 55, 63, 70)[15] and related amendments, suggest that research costs that have been previously expensed cannot be capitalized regardless if an entity uses COV to subsequently measure its intangible assets or not. In particular, IPSAS 31 paragraph 70 serves as the existing guardrail preventing the recognition of research costs by specifically stating:

> "70. Expenditure on an intangible item that was initially recognized as an expense under this Standard shall not be recognized as part of the cost of an intangible asset at a later date."

If the amendments to IPSAS 31 are retained, to ensure a consistent application of COV to Intangible Assets in its scope, in particular internally generated intangible assets, we recommend the following improvements:

ED 90, IPSAS 31.AG15 states: "In some cases, it may not be clear whether the intended primary objective of holding an intangible asset is for its operational or financial capacity. Judgement is needed. An entity develops criteria so that it can exercise judgment consistently in concluding whether an intangible asset is held primarily for its operational or financial capacity. When the intended primary objective of holding an intangible asset cannot be determined, given the overall objectives of most public sector entities, the presumption is that an intangible asset is held for its operational capacity."

[15] IPSAS 31 paragraphs 52, 55, 63, 70 and 76 together suggest that research costs should be expensed. However, an alternative view expressed by one IPSASB Board member in ED 90 (See AV5(a)), suggested that the introduction of COV would result in the capitalization of research costs that had been previously expensed:

IPSAS 31.52:

"No intangible asset arising from research (or from the research phase of an internal project) shall be recognized. Expenditure on research (or on the research phase of an internal project) shall be recognized as an expense when it is incurred."

IPSAS 31.55:

"An intangible asset arising from development (or from the development phase of an internal project) shall be recognized if, and only if, an entity can demonstrate all of the following:

(a) The technical feasibility of completing the intangible asset so that it will be available for use or sale;
(b) Its intention to complete the intangible asset and use or sell it;
(c) Its ability to use or sell the intangible asset;
(d) How the intangible asset will generate probable future economic benefits or service potential. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;
(e) The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
(f) Its ability to measure reliably the expenditure attributable to the intangible asset during its development."

IPSAS 31.63:

"The cost of an internally generated intangible asset for the purpose of Paragraph 31 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 28, 29, and 55. Paragraph 70 prohibits reinstatement of expenditure previously recognized as an expense."

IPSAS 31.70:

"Expenditure on an intangible item that was initially recognized as an expense under this Standard shall not be recognized as part of the cost of an intangible asset at a later date."

- Clarify the application of COV as it relates to research costs given the guidance in paragraphs 52, 55, 63, 70 and 76, for example through the provision of implementation guidance.
- Provide an illustrative example and/or implementation guidance to help clarify how COV should be applied for the subsequent measurement of development costs incurred under a multi-year project where an internally generated intangible asset project is not yet complete. Providing this additional guidance will help support the consistent application of COV and IPSAS 31 to these increasingly common intangible assets.