Dear Sirs,

PROPOSED TECHNICAL INFORMATION PAPER 2: DEPRECIATED REPLACEMENT COST

This response is from the Staff of the International Public Sector Accounting Standards Board (IPSASB) to the Exposure Draft (ED), Proposed Technical Information Paper 2: Depreciated Replacement Cost. The response does not represent the views of the Board itself.

We regret that the ED addresses replacement cost only as an application of the cost approach, which is, under the Draft New International Standards Framework, one means of deriving a market value. We regret that the draft does not acknowledge that replacement cost may also be used to derive the value of an asset to its owner. A brief discussion of this point would greatly enhance the usefulness of the Technical Information Paper and reduce confusion.

As part of its project to develop a Conceptual Framework for General Purpose Financial Reporting, the IPSASB has recently published a Consultation Paper, Measurement of Assets and Liabilities in Financial Statements. This includes a discussion of the suitability of replacement cost for financial reporting purposes, and distinguishes replacement cost from market value. It sees replacement cost as a possible means of deriving a value to the owner (particularly when considered in conjunction with other bases, as in the deprival value model). It is therefore consistent with the definition of ‘investment value’ given in the Draft New International Standards Framework.

The main differences between replacement cost as a means of estimating the value to the owner rather than as a means of estimating market value are:

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Sirs,
(i) the relevant service potential to be considered is the service potential that the asset will afford to the current owner, rather than to a potential purchaser; and

(ii) the relevant replacement cost is that which would be incurred by the current owner rather than by a potential purchaser.

On a more detailed point, we do not understand the observation in paragraph 57 of the exposure draft that market value would be the higher of the value of the land (after making allowance for the cost of site clearance etc.) and the depreciated replacement costs of the specialised building. This would seem to be the deprival value of the asset, but its market value could only be the former of these two amounts.

We would be happy to discuss this response further if that would be helpful, in which case please contact Andrew Lennard (a.lennard@frc-asb.org.uk) or me.

Yours faithfully,

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