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Dear Stephenie,

COMMENTS ON PHASES 2 AND 3 OF THE IPSASB'S CONCEPTUAL FRAMEWORK PROJECT

We welcome the opportunity to provide comments on Phases 2 and 3 of the IPSASB's conceptual framework project. Overall, we are supportive of the project as we believe it makes significant strides in strengthening transparency and accountability in public sector financial reporting. Our responses to the specific matters for comment are outlined in Parts A and B of this letter.

This comment letter has been prepared by the Secretariat of the ASB and does not necessarily reflect the views of the ASB Board. In formulating the comments outlined in this letter, the Secretariat has undertaken a limited consultation with its constituents in the South African public sector. This limited consultation included auditors, preparers, users of the financial statements and professional bodies.

As acknowledged in the various documents issued for comment, it may be necessary for the IPSASB to issue a complete Framework for comment once the various phases are complete. Based on the final outcome of the Framework, the views expressed in this letter may be subject to change.

Please feel free to contact me should you require clarification on any of our comments.

Yours sincerely

E Swart

Erna Swart

Chief Executive Officer

PART A - PHASE 2 ELEMENTS AND RECOGNITION

Specific matter for comment 1

Do you agree with the definition of an asset? If not, how would you modify it?

Yes, we agree with the definition of an asset. In particular, we believe that referring to "the ability" to provide economic benefits or service potential is an improvement from the previous definition as this more appropriately reflects the nature of public sector assets.

Specific matter for comment 2

(a) *Do you agree with the definition of a liability? If not, how would you modify it?*

Yes, we agree with the definition of a liability.

(b) *Do you agree with the description of non-legal binding obligations? If not, how would you modify it?*

We would re-name these definitions. The phrase "non-legal binding obligations" is cumbersome. We propose using the terms "legally binding" obligations and "other binding" obligations. We do not believe that the name "non-legal binding obligations" provides a better description of these obligations than just using the phrase "other binding obligations". The types of obligations envisaged by "other" or "non-legal binding" only becomes clearer once paragraph 3.10 has been read.

Alternatively, we propose rephrasing the term "non-legal binding" to "non-legally binding".

Specific matter for comment 3

Do you agree with the definition of revenue? If not, how would you modify it?

We do not agree with the definition of revenue, because we do not support deferred inflows and deferred outflows. See our response to specific matter for comment 5.

Consequently, we propose amending the revenue definition as follows:

Revenue is ~~(a)~~ inflows of economic benefits or service potential during the current reporting period, which increase the net assets of the entity, other than ~~(i)~~ ownership contributions~~; and (ii) increases in deferred inflows; and (b) inflows during the current reporting period that result from decreases in deferred inflows~~.

If the definition of revenue is retained, we suggest the following amendments:

- Part (a) - A reference should be added to inflows of "economic benefits or service potential".
- Part (b) – It is unclear whether decreases in deferred inflows are "inflows during the current reporting period"? As such we suggest referring only to "decreases in deferred outflows" in part (b).

We have noted in BC 38 that the Board decided not to separately define gains and losses from revenues and expenses. While we agree that gains and losses are not separate elements, we are of the view that there is merit in considering whether these items should be disclosed separately from revenue from operating activities. Gains and losses typically do not arise from recurring transactions, even though these may be part of an entity's operations (for example, it could be argued that disposing of assets at the end of their useful lives is part of an entity's operations). If these gains and losses are included with revenues and expenses that are recurring, the predictive value of the information may be compromised. Consequently, we propose that the Board consider separate presentation for gains and losses at a Standards level.

Specific matter for comment 4

Do you agree with the definition of expenses? If not, how would you modify it?

We do not agree with the definition of expenses, because we do not support deferred inflows and deferred outflows. See our response to specific matter for comment 5.

As a result, we propose amending the expense definition as follows:

Expenses are ~~(a)~~ inflows of <u>economic benefits or service potential</u> during the current reporting period, which decrease the net assets of the entity, other than ~~(i)~~ ownership distributions~~; and (ii) increases in deferred outflows; and (b) inflows during the current reporting period that result from decreases in deferred outflows~~.

If the definition is retained, we suggest making similar changes to those proposed to the revenue definition outlined above.

Specific matter for comment 5

(a) *Do you agree with the decision to define deferred inflows and deferred outflows as elements? If not, why not?*

We do not agree with the decision to define deferred inflows and outflows as separate elements for the following reasons:

- The proposed approach does not reflect economic reality at a given point in time. If an entity has gained control over resources over which no present or future obligation exists, then those resources should be reflected as an inflow in the current period as revenue.
- Deferrals do not represent actual events or occurrences during a period; they merely reflect that a period of time has elapsed. For example, an entity might be given funding to undertake certain activities in both current and future periods. Under the deferred inflows and outflows approach, an entity would recognise those resources received when it has reached the relevant reporting period, irrespective of whether it has actually undertaken any activity. We are therefore of the view that using the passing of time as a measure of whether "flows" are revenue or expenses is an inappropriate reflection of the resources available to an entity at a particular date.
- The notion of deferrals cannot be established without introducing "rules" into a principle based Conceptual Framework. It is also inappropriate that these rules are designed to distinguish between exchange and non-exchange transactions. Conceptual principles should be adequate to apply to a range of transactions, irrespective of their nature.

Based on these comments, we are of the view that the assets and liabilities definitions should be used as clear parameters within which to recognise revenues and expenses. If resources are received in a reporting period and no obligation exist over those resources, then revenue should be recognised in that period, and vice-versa for the recognition of expenses.

We support the view in BC42 that the consequence of receiving resources “earmarked” for future periods is a presentational issue (to be dealt with at a Standards-level) rather than a conceptual issue. We believe that that this issue should be addressed as part of the Board’s current work plan, particularly in relation to amendments to IPSAS 23 *Revenue from Non-exchange Transactions (Taxes and Transfers).*

(b) If you agree with the decision to define deferred inflows and deferred outflows as elements, do you agree with the:

(i) Decision to restrict those definitions to non-exchange transactions? If not, why not?

(ii) Definitions of deferred inflows and deferred outflows? If not, how would you modify them?

If deferred inflows and outflows are retained as separate elements, we agree that they should be limited to non-exchange transactions. The fact that consideration is exchanged between parties in an exchange transaction, the recognition of revenues and expenses is automatically limited based on parties’ performance. We have noted additional comments on the explanatory paragraphs that would need to be addressed if these elements are retained.

Specific matter for comment 6

(a) Do you agree with the terms net assets and net financial position and the definitions? If not, how would you modify the terms and/or definitions?

We do not agree with the term “net financial position” because we do not agree with the concept of deferred inflows and outflows. We agree with the term “net assets” and its description, including the statement that it is not an element itself. Similar to “net financial position”, we are of the view that “net assets” can be a positive or negative residual amount and this should therefore be acknowledged in the context of “net assets” and not only “net financial position”.

(b) Do you agree with the decision to define ownership contributions and ownership distributions as elements? If not, why not?

We agree with the decision to define ownership contributions and distributions as these represent the “capital contributions” in the traditional sense which, although infrequent in the public sector, do exist. If these elements are not separately defined, it would be difficult to identify and distinguish such arrangements from transfers and/or liabilities.

(c) If you agree with the decision to define ownership contributions and ownership distributions as elements, do you agree with the definitions of ownership contributions and ownership distributions? If not, how would you modify them?

We agree in principle with the proposed definitions, but would suggest the following amendments:

Ownership contributions are inflows of resources to an entity, contributed by external parties <u>in their capacity as owners [1],</u> that establish or increase <u>their</u> interest in the net assets of the entity.

[1] We are of the view that it should be clear that external parties that are making ownership contributions do so in their capacity as owners. This is a particularly relevant issue because many entities are funded by external parties merely

because of the funding mechanisms in place in the public sector. These transfers are not always made in an "ownership" capacity. Consequently, we would suggest adding this additional wording to make it clear that the contribution must be made as an owner rather than just a funder. Alternatively, this should refer only to "owners".

[2] It needs to be clear from the definition that there is not just an overall increase in the net assets of the entity (which the current wording seems to imply), but that it is the owners' interest that has been established or increased.

Ownership distributions are outflows of resources from the entity, distributed to ~~external parties~~ owners [1] that return or reduce an interest in the net assets of the entity.

[1] Ownership distributions can only be made to owners as a result of their interest, and the reference to "external parties" should therefore be changed.

(d) *Ownership interests have not been defined in this Conceptual Framework. Do you think they should be?*

We agree that ownership interests should not be defined separately as these indicate how an entity's interest in another entity arises or established, rather than it being a separate element itself. How ownership interests are demonstrated varies from jurisdiction to jurisdiction and, as a result, we are of the view this should be addressed as a standards-level issue. It would however be useful at a Standards-level how ownership interests can be demonstrated as this is often a key factor in distinguishing between revenue and ownership contributions.

Specific matter for comment 7

Do you agree with the discussion on recognition? If not, how would you modify it?

We do not agree that uncertainty related to the existence of an item should only be considered when it is measured. If this approach is followed, then an entity will recognise all assets and liabilities that meet the relevant definition of an element and can be measured reliably. This may result in a number of items being reflected in the statement of financial position at a low value because of uncertainty around the inflow of economic benefits or service potential. We do not believe that this adequately reflects how a government has exercised accountability over its resources and obligations. This approach merely reflects the quantification of all an entity's resources and obligations and is a highly complex mathematical exercise. Recognition on this basis might also increase use of a current value measurement bases as entities would need to quantify uncertainty on an ongoing basis. We do not believe that it will enhance decision-making and accountability over those assets and liabilities that an entity manages and is accountable for.

We propose using a threshold (consistent across assets and liabilities) for the recognition of assets and liabilities that best represents the use of an entity's resources by an entity. The quantification of the rights and obligations currently envisaged by the proposed approach may, in certain circumstances, be useful as additional information disclosed in the notes to the financial statements.

As an alternative, we suggest using probability as well as reliable measurement as criteria for the recognition of elements.

Other comments

Paragraph reference	Comment
Assets	
2.4	This paragraph explains the nature and uses of public sector assets rather than explaining the definition of an asset. As a result, it may be more appropriate for this paragraph to be included in the Basis for Conclusions.
2.6(b)	Part (b) refers to the ability of the entity to direct other parties on the nature and manner of use of the benefits. While we agree with this, we are of the view that the entity must be able to direct the other party so that it (the entity) benefits from this ability.
2.7(b)	It is unclear how an entity has "The means to ensure that the resources are used to achieve its objectives", considering legal ownership and access to benefits are outlined in (a) and (b) respectively.
2.7	The wording below (d) seems overly prescriptive, particularly stating that if the ability to restrict or deny access does not exist then it is questionable whether an entity has an asset. BC14 also notes that this is crucial in deciding whether a resource is an asset. There seems to be an inconsistency in the drafting of the exposure draft.
2.7	The "and" between (c) and (d) should be replaced with "or" as it is not necessary to meet all the criteria.
2.8	The 9^{th} line of the paragraph starts "Taking the example of tax…." Explains how the asset definition is applied to taxes. While we support the conclusions reached in the last sentence, it seems inappropriate to discuss the application of the definition to specific transactions and events in the Framework. It may be more appropriate to use this in the Basis for Conclusions to illustrate the Board's consideration in deliberating the various aspects of the asset definition. We would however retain the last sentence of the paragraph subject to the editorial amendment noted below.
2.8	If the paragraph is retained, we suggest the following improvements to the text of the paragraph: It is essential to determine the point or event at which such rights or powers ~~give rise to an asset of the entity~~ gives the entity the ability to access the service potential or economic benefits. There are a number of potential points at which such events may occur. Taking the example of tax, the following points in the process may be identified: (a)…(d). When the power is exercised and the rights exist to receive service potential or economic benefits or service potential, ~~as asset arises~~ a resource under the control of the entity exists.
BC6.	The last part of this paragraph explains when certain unconditional rights may give rise to assets, for example, if they are acquired in an open, active and orderly market. It is inappropriate to determine accounting requirements for specific transactions and events in the Framework. It is also inappropriate to have such a statement in the Basis for Conclusions. We propose amending the paragraph as follows: "The IPSASB noted that there can be a large number of such rights and concluded that such unconditional ~~promises~~ rights may give rise to assets~~, if~~

	~~the entity has paid for them or if the unconditional right has acquired an identifiable value in an open, active and orderly market.~~ The identification of circumstances where unconditional rights may give rise to an asset is a standards-level issue.”
BC10	To align this paragraph with the paragraph 2.6 of the exposure draft, we suggest amending the paragraph as follows: “Control entails…(a)…,~~and~~ or (b) the ability…”
BC 11	The third sentence of this paragraph states that “In addition, control can be erroneously applied to a resource in its entirety and not the individual benefits that accrue from the resource”. This statement may give rise to practical application issues. It is often difficult in practice to determine whether an entity enjoys the economic benefits or service potential of an asset as there might be other entities that also enjoy either the economic benefits or the service potential. For example, in a service concession arrangement the grantor might enjoy economic benefits from the asset, while an operator might enjoy the economic benefits of the same asset. The statement, as included in BC 11, seems to imply that an entity needs to assess various aspects of an individual assess to test whether they control that part of the asset, which might not be feasible and may result in inappropriate accounting. This sentence should either be deleted or the principle clarified.
BC14	The opening sentence notes that the existence of access to a resource is “crucial” to the meeting the asset definition. Paragraph 2.7 notes that this is merely an “indicator”. As a result, there seems to be an apparent inconsistency in the wording.
BC16	The second last sentence refers to the fact that the IPSASB considered the “risks and rewards approach”. The first and second sentences however refer to an “economic ownership” approach which focuses on the entity’s exposure to the underlying economic attributes that contribute to the asset’s value to the entity. Based on this description, it is unclear whether these two approaches are in fact the same or different.
BC19	The first sentence of this paragraph refers to “Key Characteristics”. This may need to be updated based on the Board’s decision to modify this document into the Preface to the Conceptual Framework. This is pervasive throughout the document.
Liabilities	
3.2	The word “requirement” is inappropriate in this sentence. We would propose amending the paragraph as follows: “A present obligation is a legal or other [non-legally] binding obligation ~~requirement~~…
3.10(c)	The Basis for Conclusions makes it clear that non-legal binding obligations do not arise from “moral compulsion”. It should be clear in (c) that the entity’s no realistic alternative but to settle the obligation is based on considering economic factors only.
Revenues and expenses	
4.3	The second sentence refers to a “specified” future period. It is unclear who should “specify” this reporting period. Similar to liabilities, we suggest that the wording should explicitly state that this period must be specified by an

	external party. This should also be clarified in paragraphs 5.1 and 5.2.
Recognition	
7.3	The discussion on a “past event” is adequately explained under the asset and liability discussions and it is not necessary to again discuss this aspect in paragraph 7.3. As a result, we propose retaining only the first sentence of paragraph 7.3.

PART B – PHASE 3 MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS

General

We have observed that the drafting and style of the proposed text of Phase 3 is different to Phase 2. The drafting style is similar to that of a Consultation Paper as it seems to "discuss" the measurement bases rather than outline what the concepts and principles are that should be used in selecting a measurement basis when reporting assets and liabilities in the financial statements. While we found the discussion helpful, we believe that location in the Framework itself may be inappropriate.

We therefore suggest that drafting of this Chapter should be refined and made more precise and succinct. We are of the view that concepts and principles should be described with a brief discussion on how they should be applied. It may be appropriate to summarise some of the material into a table or, to include it in the Basis for Conclusions.

Specific matter for comment 1

Do you agree that the selection of a measurement basis should be based on the extent to which a particular measurement basis meets the objectives of financial reporting? If you think that there should be a measurement objective please indicate what this measurement objective should be and give your reasons.

Chapters 2 and 3 of the exposure draft outlines, and includes detailed discussions about, an entity's assessment of financial capacity, operating capacity and cost of services in relation to the various measurement bases identified. These assessments are however not included in the discussion in Chapter 4 where the "Selection of Measurement Bases and Measurement Models" is discussed. We are of the view that the assessment of whether a measurement basis provides information about financial capacity, operating capacity or cost of services, is an important part of the selection process.

In selecting a measurement basis, the IPSASB or an entity should identify what the measurement objective should be, based on the underlying asset or liability to be measured. As a result, we support the approach to expressing a measurement objective as outlined in the Alternative View (first part of paragraph AV26) as being *"To select those measurement attributes that fairly reflect the financial capacity, operating capacity <u>and</u> cost of services of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes."* [Would replace "<u>and</u>" with "<u>or</u>", or alternatively include both "<u>and/or</u>" as it is unlikely that a measurement basis will provide information about all three financial capacity, operating capacity and cost of services.]

We do however agree with the Board's view in BC4 that it is inappropriate to link the measurement objective to a specific measurement basis or model as this may overly restrict the use of measurement bases or models at a Standards level. We are also of the view that because the qualitative characteristics and constraints should be a key consideration in the selection of a measurement basis or model, the measurement objective cannot be linked to particular bases or models.

Specific matter for comment 2

Do you agree with the current value measurement bases for assets that have been identified in Section 3? If not, please indicate which additional measurement bases should be included or which measurement bases should not be included in the Framework?

We agree with the current value measurement bases outlined for assets. In particular, we support the exclusion of fair value from this list as it is not a measurement basis in itself but rather a method of determining an exit based market value under particular circumstances.

Specific matter for comment 3

Do you agree with the approaches proposed in Section 4 for application of:

(a) The fair value measurement model to estimate the price at which a transaction to sell an asset would take place in an active, open and orderly market at the measurement date under current market conditions. If not, please give your reasons; and

(b) The deprival value model to select or confirm the use of a current measurement basis for operational assets. If not please give your reasons.

While we support the application of the two models outlined in Section 4 in certain circumstances, we do not believe that these two models should be described in the Framework. We are of the view that describing these two models, and their application to particular circumstances, should be done at a Standards-level. We also do not believe that the models are described in sufficient detail in the Framework for them to be appropriately applied either by the IPSASB or by preparers of the financial statements. As a result, we propose the following:

- The Conceptual Framework could acknowledge that particular models may need to be developed at a Standards-level to assist in selecting a measurement basis.
- Develop IPSASs that outline and describe the application of these measurement models to particular circumstances.

Specific matter for comment 4

Do you agree with the proposed measurement bases for liabilities in Section 5? If not, please indicate which additional measurement bases should be included or which measurement bases should not be included in the Framework?

We agree with the proposed measurement bases for liabilities.

Detailed comments on exposure draft

The following table outlines our detailed comments on the exposure draft.

Paragraph reference	**Comment**
1.1	This paragraph largely repeats principles outlined in the Phase 1 chapters. Consequently, it may need to be deleted when the final chapter/omnibus Conceptual Framework is being finalised.
1.3(a)	The description of “financial capacity” refers to “the capacity of the entity to continue to fund its activities and meet its operational objectives in the future”. Many of the discussions/assessments of financial capacity in

	Chapter 3 focus on whether the measurement basis reflects the selling price of an asset. It is unclear why this is the focus of the discussions as it does not seem to relate directly back to the description outlined in paragraph 1.3. We therefore suggest that the description in paragraph 13(a) should be revisited to explain how this "capacity" is demonstrated.
1.5	The second sentence refers to entry values reflecting the "cost of purchase", while exist values represent the "cost of sale". This description could be mistaken for the transaction costs related to the purchase or sale of the asset. Consequently, we propose amending this sentence as follows: "For assets, entry values reflect the purchase price paid to acquire an asset, while exist values reflect the selling price of the asset."
2.1	This paragraph discusses allocating the cost of the asset to reporting periods. This process is not unique to the "historical cost" measurement basis. As such, it should not be discussed as feature of this measurement basis, and should only be discussed in the context of an assessment of "cost of services" rather than an attribute of a particular measurement basis.
Below 3.2, Table 1	This table should be expanded to outline what "objective" (financial capacity, operating capacity or cost of service) the measurement basis best fulfils.
3.3	The definition of market value currently refers to a liability being "settled". We are of the view that this should be replaced with "transferred" as this best describes a market value for a liability. In addition, paragraph 5.6 discusses the "transfer" of a liability rather than the settlement of a liability. The reference to "settled" could be confused with the "Cost of fulfilment" in chapter 5.
3.4	The opening sentence of this paragraph states that "At acquisition, market value and historical cost will be the same, if transaction costs are ignored." In reality, market value and historical cost may not be the same as the one is an exit price, while the other is an entry value. We would therefore suggest that this sentence be reworded to state that market prices and historical cost <u>may</u> be the same.
3.11	The second sentence of this paragraph notes that "If market-based information is used for pricing decisions, the users of services could be charged with higher costs than those actually incurred". This sentence implies a close linkage between the costs incurred and the tariffs charged by entities. While this may be true for the private sector, it is unlikely in the public sector where users either pay nothing, or only a nominal fee, for goods and services received.
3.13	From the opening sentence, it is unclear whether market value provides an indication of the operational capacity of an entity. It is also unclear why the statement in the last sentence is necessary.
Section on replacement cost	Many of the paragraphs in this section refer only to "service potential" (e.g. 3.18(b) and 3.20). As assets embody both economic benefits or service potential embody both the paragraphs should refer to both economic benefits and service potential.
3.41	The definition of value-in-use refers to "remaining service potential or economic benefits….." Value-in-use often makes use of a discounted cash flow analysis. As such, we are of the view that definition should also refer to the expected cash flows.

BC27.	This paragraph states that the fair value model should only be applied when the market is inactive. This has not been articulated in the main body of the exposure draft.
4.11	If the section on deprival value is retained, then paragraph 4.11 should be reworded as the current descriptions are not useful in the context of the diagram.