Appendix 1

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements

Specific Matter for Comment 1

(a) Should the definition of an asset cover all of the following types of benefits—those in the form of:

(i) Service potential;

(ii) Net cash inflows; and

(iii) Unconditional rights to receive resources?

(b) What term should be used in the definition of an asset:

(i) Economic benefits and service potential; or

(ii) Economic benefits?

(a) All of these should be recognised.

(b) We consider that conceptually, assets must be capable of providing economic benefits. However, in practice in the context of public sector financial reporting, assets are obtained/held for two clearly defined purposes, namely to generate future economic benefits or to provide services to the public. In the context of public sector financial reporting it is therefore desirable to differentiate why assets are held (e.g. to inform valuation decisions).

Therefore we support option (i).

Specific Matter for Comment 2

(a) Which approach do you believe should be used to associate an asset with a specific entity:

(i) Control;

(ii) Risks and rewards; or

(iii) Access to rights, including the right to restrict or deny others' access to rights?

(b) Does an entity's enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others' access link a resource to a specific entity?

(c) Are there additional requirements necessary to establish a link between the entity and an asset?

(a) We consider that each of these bases is in general less clearly defined in the public sector than in the private sector because of the functions, diverse nature, structure and legal powers of public sector entities. For example risks and rewards are often not as well aligned in the public sector as they tend to be in the private sector. We have encountered various situations where one public sector entity bears the risk relating to an asset, while another entity (or

entities) reaps much of the benefit. This can result in severe difficulties in deciding on appropriate accounting treatment.

Overall, although none of the proposed bases are without flaws, we consider that 'control' best links an asset with a specific entity. However further consideration will need to be given when developing this section of the framework as to whether 'control' refers to (inter alia):

- the ability to exercise control or actual exercise of control; and
- control over the asset or the service delivery capacity of the asset.

(This issue is touched upon albeit in the context of a specific scenario, in our response to Specific Matter for Comment 4).

(b) We consider that an entity's enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others' access are essential characteristics of an asset.

(c) Not that we are aware of.

Specific Matter for Comment 3

Is it sufficient to state that an asset is a "present" resource, or must there be a past event that occurs?

We consider that there must have been an event, or a series of events, that resulted in the creation of an asset. However in practice the difficulty is often whether there is an 'identifiable' past event.

We consider that the need for an identifiable past event should not limit the recognition of an asset. Instead, the more essential consideration is whether there exists a present resource available to the entity to meet its future obligations or contribute to the entity's service potential.

Specific Matter for Comment 4

Recognition and measurement criteria aside, are public sector entity rights and powers, such as those associated with the power to tax and levy fees, inherent assets of a public sector entity, are they assets only when those powers are exercised, or is there an intermediate event that is more appropriate?

We consider that the power to tax and levy fees is in itself an asset. However we do not consider that a theoretical power to tax can in practice be measured in such a way as to provide a faithful representation of the asset.

We agree that the power to tax and levy fees should be considered as assets only when:

- *those powers are exercised; and*
- *the tax or levy due can be measured in such a way as to provide a faithful representation of the asset.*

Specific Matter for Comment 5

(a) Are there any additional characteristics that have not been identified that you believe are essential to the development of an asset definition?

(b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of assets?

(a) No

(b) No

Specific Matter for Comment 6

(a) Should the definition of a liability cover all of the following types of obligations?

(i) Obligations to transfer benefits, defined as cash and other assets, and the provision of goods and services in the future.

(ii) Unconditional obligations, including unconditional obligations to stand ready to insure against loss (risk protection).

(iii) Performance obligations.

(iv) Obligations to provide access to or forego future resources.

(b) Is the requirement for a settlement date an essential characteristic of a liability?

(a) We consider that elements (i), (ii) and (iii) should be included in the definition of a liability.

We do not support the inclusion of (iv).

(b) No.

Specific Matter for Comment 7

(a) Should the ability to identify a specific party(ies) outside the reporting entity to whom the entity is obligated be considered an essential characteristic in defining a liability, or be part of the supplementary discussion?

(b) Do you agree that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability?

(c) Which of the three approaches identified in paragraph 3.28 do you support in determining whether an entity has or has not a realistic alternative to avoid the obligation?

(a) We do not consider the ability to identify specific parties as an essential characteristic.

(b) Yes. However it must be recognised that certain public sector entities are able to change the law such that they could negate a liability. The framework should therefore consider what constitutes 'realistic' in the context of law making entities.

(c) We consider that approach (c) provides the best approach for the reasons outlined in paragraph 3.35.

Specific Matter for Comment 8

Is it sufficient to state that a liability is a "present" obligation, or must there be a past event that occurs?

We consider that there must have been an event, or a series of events, that resulted in the creation of a liability. However in practice the difficulty is often whether there is an 'identifiable' past event.

We consider that the need for an identifiable past event should not limit the recognition of a liability. Instead, the more essential consideration is whether there exists a present obligation.

Specific Matter for Comment 9

(a) Recognition and measurement criteria aside, are public sector entity obligations such as those associated with its duties and responsibilities as a government, perpetual obligations, obligations only when they are enforceable claims, or is there an appropriate intermediate event that is more appropriate?

(b) Is the enforceability of an obligation an essential characteristic of a liability?

(c) Should the definition of a liability include an assumption about the role that sovereign power plays, such as by reference to the legal position at the reporting date?

(a) Consistent with our response to Specific Matter for Comment 7, we consider that a liability should be recognised when there is no realistic alternative to avoid the obligation. In the public sector such a scenario can arise from contractual, constructive political or moral obligations. The factors that would trigger a liability are likely to vary between jurisdictions, depending on legal systems, specific legislation and political factors. We consider that in substance an enforceable claim arises out of entity having no reasonable alternative to avoid the obligation.

(b) Yes. As noted above enforceability can arise from contractual, constructive political or moral obligations.

(c) As is discussed in paragraphs 3.59 - 3.60 sovereign powers may allow a government to avoid its liabilities for example, by changing legislation. However we consider that it is necessary to assume that at the balance sheet date the government will meet all its liabilities that it is required to recognise under the relevant financial reporting framework and legislation in place at that time.

Specific Matter for Comment 10

(a) Are there any additional characteristics that have not been identified that you believe are essential to the development of a liability definition?

(b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of liabilities?

(a) No.

(b) *No*.

Specific Matter for Comment 11

(a) Should revenues and expenses be determined by identifying which inflows revenues and expenses be determined by identifying which inflows and outflows are "applicable to" the current period (derived from a revenue and expense-led approach), or by changes in net assets, defined as resources and obligations, "during" the current period (derived from an asset and liability-led approach)?

(b) What arguments do you consider most important in coming to your decision on the preferred approach?

(a) *We consider that revenues and expenses should be determined by identifying changes in net assets during the period.*

(b) *We consider that the assets and liabilities-led approach provides robust start and finish points, which in turn results in more robust measurement of financial performance. A 'revenue and expense' approach is inherently more susceptible to subjective judgements*.

Specific Matter for Comment 12

(a) Should transactions with residual/equity interests be excluded from revenues and expenses?

(b) Should the definitions of revenue and expense be limited to specific types of activities associated with operations, however described?

(a) *We consider that transactions with residual/equity interests should be treated as revenues and expenses where these result from the operations of the entity.*

However at a standards level, revenues from residual/equity interests should be analysed into revenue received:

- *for operational activities; and*
- *specifically to support the acquisition of capital assets.*

We consider that this differentiation is required to ensure comparability between entities and periods.

Increasingly, governments are requiring agencies that are not defined by IPSAS as Government Business Enterprises to enter into contracts/service level agreements with their 'parent' department. In many cases they also stipulate that their expenses do not exceed the revenue provided to them. In some instances (e.g. in the UK in certain instances) the latter is a statutory requirement. Where such agencies incur deficits, the government may need to make a capital injection to remove the deficit. It is also conceivable that governments may allow external minority participation in government agencies by the private sector who may also provide additional capital.

It is also possible that agencies may make payments of 'dividends' or other distribution of accumulated surpluses to residual/equity interests.

Such revenues/expenses:

- *are not related to the operational activities of agencies: and*
- *need to be separately identifiable to facilitate comparability and to allow users of the accounts to understand the agencies' financial performance.*

We therefore consider that such transactions with residual/equity interests should be excluded from revenues and expenses.

(b) Yes, see comments above regarding capital transactions.

Specific Matter for Comment 13

(a) Are there any additional characteristics that have not been identified that you believe are essential to the development of definitions of revenues and expenses?

(b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the definitions of revenues and expenses?

(a) No

(b) No

Specific Matter for Comment 14

(a) Do deferrals need to be identified on the statement of financial position in some way?

(b) If yes, which approach do you consider the most appropriate? Deferred outflows and deferred inflows should be:

(i) Defined as separate elements;

(ii) Included as sub-components of assets and liabilities; or

(iii) Included as sub-components of net assets/net liabilities.

(c) If defined as separate elements, are the definitions of a deferred outflow and deferred inflow as set out in paragraph 5.8 appropriate and complete?

(a) No. We recognise that intergenerational/interperiod equity and demonstrating its achievement is considered by many to be an important principle of public sector accountability. In some jurisdictions (e.g. the USA) intergenerational/interperiod equity is considered to be fundamental to public administration.

However we consider that intergenerational/interperiod equity is a policy, rather than a fundamental concept that underlies the preparation and presentation of financial statements. If a jurisdiction wishes to demonstrate intergenerational/inter period equity then this can be done through reports that accompany the accounts.

In our response to Specific Matters for Comment 11, we stated our view that the measurement of inflows and outflows should be based on movement in net assets, derived from an asset and liability-led approach. We consider that this effectively excludes the possibility of deferring income or expenditure; the balances in respect of these deferred items do not consist of amounts due from or to external parties as at the balance sheet date.

(b) Not applicable in light of our response to (a) above.

(c) Not applicable in light of our response to (a) above.

Specific Matter for Comment 15

(a) Do you consider net assets/net liabilities to be a residual amount, a residual interest, or an ownership interest?

(b) Should the concept of ownership interests, such as those that relate to minority or non-controlling interests in a GBE, be incorporated in the element definition?

(c) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of net assets/net liabilities?

(a) *We consider that the status of the net assets/net liabilities balance could vary between and within jurisdiction and entities, depending on the:*

- *nature and sources of funding of the entity;*
- *the function of the entity; and*
- *the legal and constitutional status of the entity*

We consider that in general net assets/net liabilities should be treated as a 'residual interest'.

However where an entity is financially accountable to another entity (even where the 'parent' cannot direct or control the operational policies of the 'subsidiary'), net assets/net liabilities effectively constitute an 'ownership interest'. A relevant scenario is outlined in paragraph 5.19; however we consider that in the scenario outlined, the government's interest represents an ownership interest rather than a residual interest. An ownership interest would also occur if a jurisdiction allows private investment in a government owned entity.

(b) *Yes.*

(c) *Not that we are aware of.*

Specific Matter for Comment 16

(a) Should transactions with residual/equity interests be defined as separate elements?

(b) If defined as separate elements, what characteristics would you consider essential to their definition?

(a) *Only where:*

- *An 'ownership interest' exists as outlined in our response to Specific Matter for Comment (15a);*
- *The transactions are not related to operating activities (ie they are restricted to capital injections or payment to the 'ownership interest' by means of 'dividends' or other distribution of accumulated surpluses.*

(b) *See response to Specific Matter for Comment (16a).*

Specific Matter for Comment 17

(a) Should recognition criteria address evidence uncertainty by requiring evidence thresholds; or by requiring a neutral judgment whether an element exists at the reporting date based on an assessment of all available evidence; or by basing the approach on the measurement attribute?

(b) If you support the threshold approach or its use in a situational approach, do you agree that there should be a uniform threshold for both assets and liabilities?

If so, what should it be?

If not, what threshold is reasonable for asset recognition and for liability recognition?

(a) *We support the 'measurement attribute' approach.*

(b) *We agree that a uniform threshold should be adopted for the recognition of both assets and liabilities; we consider that 'probable' would be a suitable threshold.*

Specific Matter for Comment 18

Do you support the use of the same criteria for derecognition as for initial recognition?

Yes.

Specific Matter for Comment 19

Should the recognition criteria be an integral part of the element definitions, or separate and distinct requirements?

We consider that recognition is a distinct stage in the accounting process that takes place after consideration of whether an item meets the definition of an element.