INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

Facsimile Number
1-202-623-4661

April 25, 2013

Ms. Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board (IPSASB)
International Federation of Accountants
277 Wellington Street West, 6th Floor
Toronto, Ontario M5V 3H2 CANADA

Dear Ms. Fox:

Comments on Exposure Draft 2 on Conceptual Framework: Elements and Recognition in Financial Statements

We welcome the publication of this exposure draft (ED) for comments. The ED discusses issues that are of fundamental importance to public sector financial reporting and should help promote debate on an appropriate conceptual framework for International Public Sector Accounting Standards (IPSAS). We also welcome the confirmation in the ED that the IPSASB is committed to minimizing divergence from statistical reporting guidelines where appropriate and that the conceptual framework project takes into account these guidelines to increase convergence.

Our comments on specific issues are set out below. A common theme of these comments is that the ED would benefit from more in-depth discussion on important and complex issues. The discussion should include appropriate examples of the application of the concepts and principles proposed. Where appropriate, the discussion should also be explicit about the implications of the concepts proposed, particularly where these involve any change from current principles, standards, and practice.

Definition of liabilities

A liability is defined as "a present obligation that arises from a past event where there is little or no realistic alternative to avoid an outflow of service potential or economic benefits from the entity." The ED also notes that liabilities include non-legal binding obligations when: (a) the government entity has indicated to other parties that it will accept certain responsibilities; (b) as a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and (c) the entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

The ED should clarify how the proposed definition of liabilities, and in particular the reference to non-legally binding obligations, relates to concepts of liabilities in IPSAS 1 (which does not explicitly mention non-legally binding obligations) and IPSAS 19 (which does) and whether IPSASB considers this to be a change or merely a reiteration of existing concepts, principles and practices.

We do understand the rationale for including non-legally binding obligations in the definition of liabilities under certain circumstances. However, we would recommend being more circumscribed and precise as to what those circumstances are, i.e., the extent of and limitations to the applicability of the principle of liabilities arising from non-legal obligations. To elaborate on this last point, the discussion on non-legally binding obligations in paragraphs 3.11 to 3.12 could in particular be clarified by:

- discussing in more detail the possible "natures" of these obligations, and the consequences on the point at which such obligations should be recognized.[1] In particular, a discussion of the differences between obligations deriving from exchange and non-exchange transactions would be necessary; and

- providing a clearer[2] and more comprehensive set of indicators examples, though recognizing that it will not be possible (or desirable) to anticipate every eventuality.

In addition, terms such as "little or no realistic alternative," or "valid expectation," "certain responsibilities" are not defined or explained and would require interpretations to be exercised by the preparers of the financial statements, or by auditors. We are concerned that this could present difficulties, particularly in countries with capacity constraints. This could also lead to a lack of comparability between countries. The ED should therefore discuss these terms in more depth and provide examples to facilitate understanding.

Financial performance of governments

We would suggest that the ED discuss the concept of financial performance of the public sector in a broader context. The ED does not discuss the important issues of what constitutes financial performance in the public sector and how it should be measured or assessed, other than to simply note that the difference between revenues and expenses is the entity's surplus or deficit for the period and this is the primary indicator of financial performance. This would

---

[1] The ED states that "the point at which a non-legal binding obligation gives rise to a present obligation critically depends on the nature of the obligation."

[2] For example, one indicator is "the ability of the entity to modify or change the obligation before it crystallizes." The illustration given is that the announcement of a policy does not give rise to a liability as this policy can be modified before being implemented. It is noted that "similarly, if an obligation is contingent on future events occurring there may be discretion to avoid an outflow of service potential or economic benefits before those events occur." Though there seem to be no similarity between those two situations: in the second one, the non-recognition of the liability is not linked to the ability of the entity to modify or change the obligation, but to the occurrence of future events that may or may not be under the control of the entity.

appear to be a somewhat narrow and, in certain circumstances, inappropriate view of public sector financial performance. For example, the ED’s exclusive focus on surplus or deficit would imply that if a government, at a consolidated level, had a surplus in one year, followed by a smaller surplus or a deficit in the next year, the financial performance of the government in the second year would be regarded as worse than that of the first year. However, the smaller surplus or the deficit may be caused by lower revenues and higher expenses (e.g., unemployment benefits) due to factors outside the control of the government in a period of economic downturn and not due to worse performance by the government. The lower surplus or the deficit could also be the result of deliberate policies and actions by the government to stimulate the economy in the midst of a recession. Under such circumstances, it would be misleading to conclude that the government’s financial performance has deteriorated, particularly if there are indications that the government’s policies have led to better economic outcomes such as higher growth and/or lower unemployment. We therefore believe that conceptual framework should avoid taking an overly technical and narrow view of public sector financial performance and acknowledge that a government’s financial performance has to be viewed in a broader context than that of a private sector entity and provide guidance on issues in addition to the surplus or deficit that should be taken into account in assessing such performance.

Net assets of government

The ED defines net assets as the difference between assets and liabilities, but does not discuss what this indicator means for a government at either the consolidated or the entity level. The ED could usefully discuss, particularly in the context of the elements and recognition criteria proposed in the ED, whether or not net assets of governments should be viewed as an indicator of a government’s financial strength, solvency, or fiscal sustainability or a combination thereof. The ED could also discuss any limitations that may apply in using net assets as an indicator for such analytical purposes.

Deferred inflows and outflows

While we appreciate the conceptual arguments for distinguishing deferred inflows and outflows from other transactions, we are concerned that the proposed introduction of these new elements could increase the complexity of financial statements to such an extent as to outweigh the potential benefits.

In this context we have some sympathy with the alternative view included in the ED about the risks of moving away from the commonly understood concept that revenues increase and expenses decrease net assets.

We are also concerned that the distinction between net assets and net financial position would be difficult for users to understand. In particular, users may be confused by a balance sheet that shows a positive net asset but a negative net financial position or vice versa. For example, BC 47 states “ …negative net financial position indicates that insufficient revenues have been generated at the reporting date to meet the expenses of the entity in the provision of services and should raise the question about how this shortfall will be addressed in future periods, whether from increased revenue, a reduction in expenses, or a combination of both." The ED should discuss how these questions might be modified if the balance sheet simultaneously showed a positive net assets position and a negative net financial position. More generally, the ED could explain how to interpret balance sheets with different combinations of net asset and net financial position and changes to such combinations over time.

We also note that the proposed term "net financial position" is very similar to the term "net financial worth" used in *GFSM 2001,* although they mean very different things. This could be a source of additional confusion among users of financial and statistical reports.The ED should also discuss more fully why the concepts of deferred inflows and outflows are restricted to non-exchange transactions.

Recognition of elements

The ED notes that "… if it is determined that an element exists, uncertainty about the flows of service potential or economic benefits related to that element are taken into account in the measurement of that element." We would suggest that this concept should be explained more fully. In particular, the ED should clarify if this represents a change from the existing practice under which, for example, a provision is recognized when, among other things, it is considered probable that an outflow of resources will be required to settle the obligation. Our understanding is that under this principle where the probability of an outflow is considered less than 50 percent, a provision is not recognized. The ED should clarify whether the conceptual framework is proposing a change whereby these items that are currently not recognized, would be recognized in the future and the probability of the outflow would be taken into account in the measurement of the provision.

We hope that you find these comments useful and we look forward to continuing this important dialogue.

Sincerely yours,

Richard Hughes
Division Chief
Public Financial Management Division
Fiscal Affairs Department

cc: Ms. Moretti, Messrs. Khan, Mueller, Olden, Pessoa, van Eden