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By email: stepheniefox@ifac.org

Dear Stephenie

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

CPA Australia, the Institute of Chartered Accountants in Australia and the Institute of Public Accountants (the Joint Accounting Bodies) are pleased to respond to the IPSASB Conceptual Framework (CF) Consultation Paper (CP) Elements and Recognition.

The Joint Accounting Bodies represent over 190,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

The Joint Accounting Bodies preferred approach is for an international reporting framework comprised of a single set of concepts designed for application to all sectors. However, we acknowledge that this is not the way that standard setting internationally is structured today. Nevertheless, we encourage the IPSASB to continue to initiate dialogue with the Trustees of the IFRS Foundation about the imperative for action to expand the objective of the IASB to develop a single set of accounting standards appropriate for all sectors. The Joint Accounting Bodies will continue to make such representations nationally and internationally.

The Joint Accounting Bodies consider the completed conceptual frameworks of the IPSASB and the IASB/Financial Accounting Standards Board (FASB) will represent international best practice for entities of the public sector and the private for-profit sector respectively. However, the journey to completion is not proceeding contemporaneously. The IASB/FASB has decided not to proceed yet with a discussion paper on elements and recognition. We believe it appropriate that the IPSASB has exposed its thinking on this topic. However, we are concerned that differences in the decisions of the IPSASB and the IASB/FASB (when they eventually get to this topic) may prove problematic for transaction neutral jurisdictions like Australia should jurisdictions choose to maintain the approach of one set of standards and at the same time ensure that international investors understand that the financial reports of for-profit entities accord with the International Financial Reporting Standards (IFRS). To militate against the risk of this outcome, we encourage the IPSASB to maintain dialogue with the IASB/FASB on this topic and other conceptual framework topics.

The response of the Joint Accounting Bodies to the questions posed is appended. If you require further information on any of our views, please contact Mark Shying, CPA Australia by email mark.shying@cpaaustralia.com.au, Kerry Hicks, the Institute of Chartered Accountants by email kerry.hicks@charteredacccountants.com.au or Tom Ravlic, the Institute of Public Accountants by email tom.ravlic@publicaccountants.org.au.

Yours sincerely

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Appendix

Specific Matters for Comments

Question 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?**

The Joint Accounting Bodies support the definition of an asset that covers all three types of benefits listed above.

b. **What term should be used in the definition of an asset:**
    i. **Economic benefits and service potential; or**
    ii. **Economic benefits?**

The Joint Accounting Bodies believe that economic benefits or service potential is the essence of assets – an approach that was articulated in SAC 4 *Definition and Recognition of the Elements of Financial Statements* in pre-IFRS Australian GAAP. We consider economic benefits as synonymous with the notion of service potential. In pursuing their objectives, both public sector not-for-profit entities and profit seeking entities provide goods and services that have the capacity to satisfy human wants and needs. Both types of entity create utility and value in essentially the same way – by using assets to provide goods and services that their customers or beneficiaries desire or need. Thus, assets provide a means for entities to achieve their objectives and in the case of the public sector, that objective might only sometimes give rise to net cash inflows. While we do not differentiate economic benefits from service potential, as noted in paragraph 2.23 of the CF CP Elements and Recognition other commentators like to. We are agreeable to the use of either approach. The critical issue is that the notion of service potential is included in the Framework and that if option b(ii) is used, their synonymous nature is articulated. Irrespective of the final approach, a discussion of assets in the finalised Framework should highlight that the multiple objectives of public sector entities may result in their holding assets to use to either deliver goods and services in accordance with the entity's objectives, or to generate net cash inflows.

Question 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?**

The Joint Accounting Bodies consider control is an essential feature of an asset. We note that any discussion of approaches focuses people's attention on questions such as 'which asset?' – 'rights of use', 'rights of access', 'future rights to acquire', 'future rights to use', 'future rights to sell', 'rights to ownership of the underlying asset', and 'ownership of the underlying asset'. While we support an approach that includes access to rights, including the right to restrict or deny others' access to rights, we think in important that the Framework address the question of which asset (i.e., the unit of account issue).

We note that an approach based on risks and rewards has been used in some jurisdictions. Further, some commentators consider risks and rewards as a component of control and/or access to rights, and hence should be an input into the determination of control or access to rights. We suggest that the Framework include a discussion or risks and rewards that gives clarity to the distinction or interrelationship between the approaches of control and access to rights and the risks and rewards approach.

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?**

The Joint Accounting Bodies do not consider that an enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others' access, is a precondition to linking a resource to a specific entity, rather it could be an indicator.

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

The Joint Accounting Bodies are yet to identify any additional necessary requirements.

Question 3
Is it sufficient to state that an asset is a "present" resource, or must there be a past event that
occurs?

The Joint Accounting Bodies believe it is sufficient to state that an asset is a present resource. However, we acknowledge that a past transaction or event may be useful as an indicator that an asset exists. Therefore, we support the statement to this effect made at paragraph 2.47 of the CF CP Elements and Recognition.

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Question 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?

The Joint Accounting Bodies consider the unique powers and rights of government such as the power to tax and issue licences are assets. Therefore, we consider it important that the asset definition is kept general and broad. Whether or not an asset is recognised in the financial statements is, and should remain, a separate matter and be dependent on the asset satisfying prescribed recognition criteria. The finalised Framework must be clear on this sequencing.

Question 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?**

The Joint Accounting Bodies have not identified any additional characteristics or other relevant issues. However we would encourage continued liaison with the IASB/FASB to develop a consistent definition of an asset.

Question 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.**

It is the view of the Joint Accounting Bodies that the Framework definition of a liability needs to be general and broad – that is, there is an obligation to transfer benefits to another party until it is settled and that the entity has no realistic alternative to avoid the obligation. To the extent that an entity has no realistic alternative to avoid the obligation, we agree that the types of obligations described in (a)(i) to (iii) are liabilities. Obligations to provide access to future resources are different from obligations to forgo future resources. We agree that an obligation to provide access is a liability, if the entity has no realistic alternative to avoid the obligation. However, we do not agree that an obligation to forgo future resources is a liability as the circumstance as described may lack an essential characteristic of a liability - an obligation to transfer benefits to another party until settled.

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

The Joint Accounting Bodies believe a settlement date is not an essential characteristic of a liability. However, we acknowledge that a settlement date may be useful as an indicator that a liability exists in the context of a contractual arrangement, but it is not always relevant or necessary.

Question 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?

The Joint Accounting Bodies do not consider that the ability to identify a specific party(ies) outside the reporting entity to whom the entity is obligated should be considered an essential characteristic in defining a liability. Although we consider an essential characteristic of a liability is an obligation to transfer benefits to another party until settled, we do not think it essential to identify the other party.

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

Yes, the Joint Accounting Bodies 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?

The Joint Accounting Bodies support a definition of a liability that is kept general and broad. We consider that the definition of a liability should be applicable to all types of obligations with no distinction between exchange and non-exchange obligations. The approach (c) is the only approach that extends the application of constructive obligations to non-exchange transactions from which the public sector entity cannot realistically withdraw. Therefore, we think of it as the most supportable. Notwithstanding the prevalence of constructive obligations in the public sector (when compared with the private sector), we suggest that a better approach is for the IPSASB to focus the development of its definition of a liability on whether obligations are conditional or unconditional. We consider that an entity has a liability only in respect of unconditional obligations and that many obligations to provide future benefits (in a non-exchange setting) would be conditional obligations. We also consider that the definition of a liability should encompass unconditional stand ready obligations. We consider an entity has a liability when it has an unconditional obligation from which it cannot realistically withdraw, regardless of whether that obligation is contractual or constructive.

Question 8
Is it sufficient to state that a liability is a "present" obligation, or must there be a past event that occurs?

The Joint Accounting Bodies believe it is sufficient to state that a liability is a present obligation. However, we acknowledge that a past event may be useful as an indicator that a liability exists.

Question 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?**

The Joint Accounting Bodies consider the inherent responsibilities of government to provide security, education, health and other services to its citizens do result in the existence of perpetual obligations to transfer benefits to another party and that the government has no realistic alternative to avoid these obligations, and therefore, they are a liability. We consider it important that the liability definition is kept general and broad. Whether or not a liability is recognised in the financial statements is, and should remain, a separate matter and be dependent on the liability satisfying prescribed recognition criteria. The finalised Framework must be clear on this sequencing.

b. **Is the enforceability of an obligation an essential characteristic of a liability?**

The Joint Accounting Bodies do not support 'enforceability of an obligation' as an essential characteristic of a liability. However, we acknowledge that enforceability may be useful as an indicator that a liability exists.

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?**

The Joint Accounting Bodies believe a general and broad definition of liabilities is able to deal appropriately with the issue of sovereign power. As noted in our response to Question 7(c) above we consider that an entity has a liability when it has an unconditional obligation from which it cannot realistically withdraw. Therefore, the definition of a liability will only be satisfied on those occasions when the consequences to the government of exercising its sovereign power to avoid its obligations are such that withdrawal is not a realistic option. In all other instances, the liability definition will not be satisfied

Question 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?**

The Joint Accounting Bodies have not identified any additional characteristics or other relevant issues. However we would encourage continued liaison with the IASB/FASB to develop a consistent definition of a liability.

Question 11

a. **Should 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),**
b. **or by changes in net assets, defined as resources and obligations, "during" the current period (derived from an asset and liability-led approach)?**
c. **What arguments do you consider most important in coming to your decision on the preferred approach?**

The Joint Accounting Bodies consider that revenues and expenses should be determined by an 'asset and liability-led approach'. We believe that economic benefits or service potential as well as the obligation to transfer them are the essential characteristics of the asset/liability and that revenues and expenses should reflect changes in those economic benefits or service potential and obligations. We agree with the views expressed at paragraph 4.11 of the CF CP Elements and Recognition that assets and liabilities are the principal building blocks of the system to give meaning to financial performance.

Question 12

a. **Should transactions with residual/equity interests be excluded from revenues and expenses?**

The Joint Accounting Bodies believe that when the transaction is one with the holders of residual/equity interests who are acting in that capacity, such transactions should be excluded from revenues and expenses. Therefore, we support the view outlined in paragraph 4.41 of the CF CP Elements and Recognition that contributions intended to be an investment in the initial operating capacity of the entity or, subsequently to increase it, should be excluded from revenues. We also support the related treatment of distributions outlined in paragraph 4.41.

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

The Joint Accounting Bodies consider the definitions of revenue and expense should include inflows from all transactions and events other than transactions with the holders of residual/equity interests when they are acting in that capacity. We do not support limiting the definitions to specific types of activities.
We note that the IASB/FASB use of "other comprehensive income" does not have a basis in its CF. We encourage the IPSASB to explore its use as part of the development of its CF in liaison with the IASB/FASB to develop a consistent definition.
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Question 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?**

The Joint Accounting Bodies have not identified any other characteristics or issues. However we would encourage continued liaison with the IASB/FASB to develop a consistent definition of revenues and expenses.

Question 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?**

The Joint Accounting Bodies do not support the identification of deferred outflows and deferred inflows as they are not derived from the 'asset and liability-led approach'.

Question 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?**

The Joint Accounting Bodies agree it is important that the finalised Framework specify the status of ownership-type interests in the public sector. It is our view that when a transaction is one with the holders of residual/equity interests and they acting in that capacity, such transactions should be excluded from revenues and expenses. Therefore, the finalised Framework will need to acknowledge the existence of, on occasions, ownership interests in the public sector and in some cases there may be no identifiable ownership interest. For this reason, we consider that net assets/net liabilities should be regarded as a residual amount, and in many cases, this residual will represent an ownership interest. Therefore, we support the approach set out in paragraph 5.25(a) of defining net assets/net liabilities and treating any specific ownership interest as a sub classification of net assets.

Question 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?**

No, the Joint Accounting Bodies do not believe it is necessary to define as separate elements transactions with residual/equity interests. While we consider that net assets/net liabilities should be regarded as a residual amount, and in many cases, this residual will represent an ownership interest, there will not be an identifiable ownership interest in every case. If a residual amount approach is adopted, we do not consider that this precludes acknowledgement of ownership interests. However, we do not consider that ownership interests should be defined as a separate element.

Question 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?**
c. **If not, what threshold is reasonable for asset recognition and for liability recognition?**

The Joint Accounting Bodies support a recognition criteria that requires preparers to utilise neutral judgment to review and assess all available evidence in determining whether sufficient evidence exists that an asset or liability should be recognised initially, whether it continues to qualify for recognition, or whether there has been an addition to an existing asset or liability.

Question 18
Do you support the use of the same criteria for derecognition as for initial recognition?

The Joint Accounting Bodies support the finalised Framework utilising the same criteria for derecognition as for recognition.

Question 19
Should the recognition criteria be an integral part of the element definitions, or separate and
distinct requirements?

The Joint Accounting Bodies believe that the finalised Framework needs to be clear on the relationship of the recognition criteria to the element definitions. We consider it important that the element definitions are kept general and broad. Whether or not an element is recognised in the financial statements is, and should remain, a separate matter and be dependent on the element satisfying prescribed recognition criteria. The finalised Framework must be clear about this sequencing.