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International Public Sector Accounting Standards Board
International Federation of Accountants
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Dear Stephenie

Conceptual Framework Exposure Draft 2 Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements

Thank you for the opportunity to comment on the above. CPA Australia and the Institute of Chartered Accountants in Australia (the Institute) have considered the proposals and our comments follow. CPA Australia and the Institute represent over 200,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

Our preferred approach is for an international reporting framework comprised of a single set of concepts designed for application to all sectors. The Memorandum of Understanding between the International Accounting Standards Board and the International Federation of Accountants notes the importance of involving the International Accounting Standards Board technical staff in the IPSASB's development of a conceptual framework for public sector entities (Framework). We are pleased that this is taking place and we hope that it will continue with an increasing focus now that the IASB are progressing with their conceptual framework project. We commend the IPSASB on publishing the first four chapters of the Framework. We also agree with the decision of the IPSASB to defer approval and publication of the Preface to the Framework until the Framework is being finalised. This will allow the linkages with the concepts in the Framework to be made more explicit. Furthermore, we believe the Framework would benefit from an IPSASB review of all the published chapters as part of the finalisation process. As well as enabling the linkage of concepts to be made more explicit a review of this type enables the Framework to be subjected to a contemporary holistic evaluation before its finalisation.

At the Framework level we consider it important that the asset and liability definitions are kept general and broad. Further, we believe that assets and liabilities should be the principal building blocks of the Framework. For this reason we do not support the IPSASB's proposals in Conceptual Framework Exposure Draft 2 (ED) to define 'deferred inflows' and 'deferred outflows' as new elements used in financial statements.

The Appendix to this letter contains our general comments and our response to the questions for comment. If you require further information on any of our views, please contact Mark Shying, CPA Australia by email mark.shying@cpaaustralia.com or Kerry Hicks, the Institute by email kerry.hicks@charteredaccountants.com.au.

Yours sincerely

Alex Malley
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Appendix

General comments

We believe that assets and liabilities are the principal building blocks of the system to give meaning to financial performance through the reporting of economic phenomena in the form of economic resources and obligations. This system was described in an earlier IPSASB Consultation Paper *Elements and Recognition in Financial Statements* as an asset and liability-led approach. On reading the ED it is our conclusion that the IPSASB has rejected the asset and liability-led approach in favour of a revenue and expense-led approach. In turn, this means that assets (and liabilities) are not considered to be the principal building blocks – which is an outcome that we do not support.

Specific Matter for Comment 1

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

We support the proposed definition of an asset as it is general and broad and it captures the economic phenomena that we believe is the essence of the definition of an asset. However, we do note that the use of the term 'future economic benefits' could simplify the definition if it is used to encompass both 'economic benefits' and 'service potential'.

We consider the relationship between service potential and economic benefits is unclear from paragraphs 2.3 to 2.4 of the ED. The explanation in paragraph 2.3 describes service potential broadly to be likely to encompass all assets without necessarily generating cash flows. BC 8 explains that the term 'economic benefits' relates to the ability to generate net cash flows, which sounds like it could be considered a subset of service potential.

We recommend that the wording is changed as above, and the guidance clarified to indicate that service potential was a sub-set of future economic benefits.

Specific Matter for Comment 2

a. **Do you agree with the definition of a liability? If not, how would you modify it?**
b. **Do you agree with the description of non-legal binding obligations? If not, how would you modify it?**

We do not support the proposed definition of a liability as we consider that the inclusion of 'little or no realistic alternative to avoid' is more in the nature of a recognition criteria than a definition. This is because 'little or no realistic alternative to avoid' is specifically applicable to the entity assessing the liability and therefore should not be used in a definition.

Further, we consider that some of the guidance in the Basis of Conclusion needs further work. In particular, we note the Basis for Conclusions to the ED states "distinguishing between conditional and unconditional obligations is not useful for the purpose of defining a liability…[and] the notion of a stand-ready obligation does not work well in a public sector non-exchange context…". . It is our view that the ED definition has been developed to reflect these views. We do not support this approach.

We note that the IASB work to date in its Conceptual framework project treats the distinction between conditional and unconditional rights as fundamental to identifying whether assets and liabilities exist. We are unaware of any public sector rationale for any differences to this principle. Further, including this principle would remove the need to consider whether contracts are executory, which means the discussion in BC 7 could be removed.

Therefore, we suggest that the definition of a liability be established 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. Finally, 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.

We also consider that the definition of a liability should encompass 'stand ready obligations'. Noting that we disagree with the discussion in BC24 that states that the notion of stand-ready obligations 'does not work well in the public sector' and that it 'would not provide a sound basis for future standard setting'. We consider that the 'social benefits obligation' potential for liability recognition may be the issue that the IPSASB is trying to avoid. We do not consider the elements need to change for this one issue, as guidance on this issue can be developed at the standards level.

Further, we note that the last sentence in BC26 states that 'because performance obligations are normally conditional obligations …., it would not be appropriate to use the term "performance obligation" in the Framework'. We also disagree with this comment as it is based on a mistaken presumption that performance obligations are conditional obligations. We also note that performance obligations are fundamental to the upcoming IFRS on revenue recognition, which is yet to be considered by the IPSASB.

Specific Matter for Comment 3

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

Specific Matter for Comment 4

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

Our answer to Specific Matters for Comment 3 and 4 follow. We do not agree with the proposed definitions or revenue or expenses.

We believe that revenue and expense should be determined by an asset and liability-led approach. It is our view that revenue and expense should reflect all changes in economic resources and not just those changes that represent inflows or outflows of resources. To accommodate this view of revenue and expenses would necessitate expanding their definitions to provide for those remeasurements of assets and liabilities that do not represent inflows and outflows of resources, for example revaluation increments and decrements of property, plant and equipment. Further, the references to 'deferred inflows' and 'deferred outflows' should be removed. As we have mentioned above, we do not support these items being separate elements.

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?**
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?**

We do not agree with the decision to define deferred inflows and outflows as elements. As stated in our general comments and responses to specific matters for comment 3 and 4 above we support an asset and liability led approach under which deferred inflows and deferred outflows are not identified as elements. It is our view that assets and liabilities are the principal building blocks of the system to give meaning to financial performance through the reporting of economic phenomena, with revenue and expenses reflecting changes in those phenomena. We do not support identifying deferred inflows and deferred outflows as elements because to do so requires constraining the Framework definition of the elements assets and liabilities and expanding the Framework to include as new separate elements the time dimension of existing elements. We believe this outcome can only add to the complexity in financial reporting and is not consistent with addressing the concerns of stakeholders about financial reporting as articulated in the expectation gap literature.

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?**
b. **Do you agree with the decision to define ownership contributions and ownership distributions as elements? If not, why not?**
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?**
d. **Ownership interests have not been defined in this Conceptual Framework. Do you think they should be?**

We believe it is important that the finalised Framework specify the status of ownership-type interests in the public sector. It is our view that there will exist, 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 should be regarded as a residual amount, and in many cases, this residual will represent an ownership interest. We support the definition of net assets and a treatment whereby any specific ownership interest is a sub-classification of net asset.

For the reasons stated in our general comments and to the specific matters for comment above we see no place in the Framework for the term 'net financial position' or its definition.

Specific Matter for Comment 7

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

We agree with the proposal in the ED that the Framework treat the recognition criteria as a separate and distinct phase from the establishment of the definitions of the elements of financial statements.

However, we note that although Section 7 of the ED is headed 'Recognition Criteria' no explicit recognition criteria are set out. We recommend that explicit recognition criteria are included.

We also believe that the recognition criteria should be neutral , meaning the same for all assets and liabilities, as well as being a neutral judgement whether the element exists at reporting date.

Paragraph BC52 identifies two types of uncertainty that need to be considered in determining whether an element should be recognised – existence uncertainty and measurement uncertainty. As we are not familiar with the concept of existence uncertainty we had expected that its explanation in the Framework would enable us to assess its level of neutrality. As our expectation was not satisfied we encourage the IPSASB to improve the quality of the explanation given.

The Framework describes a second type of uncertainty; measurement uncertainty. After reading that description we have concluded that the Framework supposes a monetary item including zero can always be attached to the item being measured. We disagree. We believe there may be occasion when for a particular item there is no measurement basis that satisfies the qualitative characteristics of the Framework. Consequently, the item being measured is not able to have a monetary item attached to it.