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Technical Director
International Public Sector Accounting Standards Board
277 Wellington Street West, 6th Floor
Toronto, Ontario M5V 3H2 CANADA

Subject: International Public Sector Accounting Standards Board Consultation Paper, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements*

The U.S. Government Accountability Office (GAO) is pleased to provide its comments on the International Public Sector Accounting Standards Board (IPSASB or "Board") Consultation Paper entitled *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements*. We commend the IPSASB on developing its Conceptual Framework project to develop concepts, definitions, and principles that respond to the objectives, environment and circumstances of governments and public sector entities. We also appreciate that, to accommodate the differences between government financial reporting practices and special considerations, flexibility is an important concept for consideration.

The Board has asked respondents for comments on the specific matters discussed in this Consultation Paper. We have provided responses in the enclosure. Please contact me at (202) 512-9471, franzelj@gao.gov or Robert Dacey, Chief Accountant, at (202) 512-7439, daceyr@gao.gov if you have any questions on GAO's perspectives.

Sincerely yours,

Jeanette Franzel,
Managing Director
Financial Management and Assurance

Enclosure

GAO Responses to Questions Set Forth in the IPSASB Consultation Paper
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?

Response: We believe that an asset includes both economic benefits and service potential. We also believe that it is important to analyze the individual rights embodied in a resource in determining whether such rights are considered to be assets. In the U.S Federal Government, an asset is defined as a resource that embodies economic benefits or services that the federal government controls. As used in Statement of Federal Financial Accounting Concepts 5, *Definitions of Elements and Basic Recognition Criteria for Accrual-Basis Financial Statements* (SFFAC 5), developed by the Federal Accounting Standards Advisory Board (FASAB), economic benefits may result in inflows of cash, cash equivalents, goods, or services to the federal government. SFFAC 5 also recognizes that services embodied in an asset may benefit the government in other ways. For example, assets such as public parks, museums, and art galleries often provide recreational, educational, and research opportunities to the public at no charge or for a reduced fee or voluntary contribution, thereby assisting the federal government to achieve its objectives and meet its mission to provide public services.

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?

Response to comment 2 (a) and (b):

We believe that control is the primary approach that should be used. Consistent with FASAB's SFFAC 5, control is an essential characteristic that should be used to associate an asset with a specific entity. FASAB defines control as the *ability* of the federal government to obtain the economic benefits or services embodied in a resource and to deny or regulate the access of others. It is possible that the government does not actively *exercise* control of the asset. Nevertheless, as long as the government currently has the ability to exercise control, the item is an asset of the government.

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

Response: We are not aware of other issues that need to be discussed.

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?

Response: Consistent with SFFAC 5, we believe that implicit in the definition and essential characteristics of an asset is that an event giving rise to the government's ability to control access to the economic benefits or services embodied in a resource must have occurred.

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?

Response: We believe that the government's rights and powers are only assets when they are exercised. The government's intent or ability to acquire a resource in the future does not create an asset. For the resource to qualify as an asset, the government already must have acquired the resource or otherwise obtained access to the economic benefits or services it embodies to the exclusion of other entities. For example, the mere existence of the government's power to tax is not an asset because, until the government has exercised that power by imposing a tax and has access to benefits by virtue of completion of a taxable event, no event has occurred to generate resources and there are no resulting economic benefits that the government can control and use in providing programs and services.

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?

Response: We have no comments to offer on specific matters for comment 5(a) or (b).

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

Response:
We believe that the definition of a liability should be limited to obligations to transfer benefits, defined as cash and other assets, and the provision of goods and services in the future based on events that have occurred or conditions that exist.

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

Response: Consistent with SFFAC 5, an essential characteristic of a liability is that a law, an agreement, or an understanding between the government and an entity identifies the conditions or events that will determine when the obligation will be settled. If, at the reporting date, these conditions have not been met and the government is free to decide whether and when to settle its obligation, the obligation does not meet the definition of a liability.

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?

Response: We believe that the identification of a specific party(ies) is not an essential characteristic of a liability. Frequently, the federal government knows before the settlement is due which specific recipients will receive the settlements. However, such advance identification of recipients is not an essential characteristic of a liability. For example, the government may have a long-term disability agreement with current employees without knowing the identity of each employee who will qualify for payment.

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

Response: We do not have a response to this specific matter for comment. The conceptual framework for the U.S. government does not include the absence of a realistic alternative as 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?

Response: We support the first approach of enforceable obligations as described in paragraphs 3.29 through 3.32.

The distinction between exchange or non-exchange transactions is important in determining the point of liability recognition, in examining whether non-exchange transactions are enforceable, and in clarifying the definition of a liability. Both IPSASB and FASAB standards define exchange and non-exchange transactions similarly. [1] For non-exchange transactions, a liability should be recognized for any unpaid amounts due as of the reporting date. This includes amounts due from the federal entity to pay for benefits, goods, or services that have been provided under the terms of the program, as of the federal entity's reporting date, whether or not such amounts have been reported to the federal entity.

Grants, subsidies, and entitlement programs are examples of non-exchange transactions. When a government creates an entitlement program or gives a grant, the provision of the payments is determined by law rather than through an exchange transaction. Thus, such liabilities derive directly from law and its implementing regulations that specifically require the government to transfer benefits or provide goods and services to another entity. Generally, governments establish eligibility criteria for determining whether and when a recipient is legally entitled to receive a non-exchange benefit. Accordingly, a liability is not established and recognized until the beneficiary meets all of the eligibility criteria which include time requirements. For example, according to FASAB standards a liability is recognized for non-exchange transactions when it is legally due and payable. As a result, Social Security benefits are recorded as a liability at the end of the fiscal year for the benefits payable in the following month, as that is the only benefit for which the recipient has met all of the eligibility requirements and is therefore entitled to receive a benefit. As defined in paragraph 3.30 of the Consultation Paper, enforceable obligations include those that are established by contract or that are otherwise enforceable by a court of law. Including enforceability as criteria allows for variations in laws in different jurisdictions and generally can be objectively determined.

We believe that it is appropriate to recognize only transactions that are enforceable because while a government may have historically provided goods and services to recipients, we believe it does not have an obligation to continue to provide these benefits prospectively beyond what is enforceable as of the reporting date. The financial statements should recognize the cost of non-exchange transactions during the reporting period in which the goods and services or transfers are provided to the recipients. Also, recognizing only enforceable obligations avoids recognizing significant liabilities without the benefit of recognizing future assets expected from cash inflows such as the right to tax. Furthermore, it is our view that the creation and recognition of a liability beyond what is enforceable would not reflect the true nature of non-exchange programs, the extent of the government's responsibilities for

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[1] Under FASAB, an exchange transaction arises when each party to the transaction sacrifices value and receives value in return. As defined in IPSASBs Glossary, an exchange transaction arises when one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange. Under FASAB, a non-exchange transaction arises when one party to a transaction receives value without directly giving or promising value in return. As defined in IPSASBs Glossary, a non-exchange transaction arises when an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

these programs, nor the government's ability to revise these programs. While government spending on programs such as defense and education, and social benefits are relatively certain to continue, they do not constitute present obligations of the government until they are enforceable.

In conclusion, it is our view that a liability for non-exchange transactions should be recognized at the reporting date only for the amount of the benefit payment that is "due and payable" that is, legally owed to the beneficiary but was unpaid as of the reporting date. We do not consider estimates for future non-exchange benefits that are not enforceable to be liabilities. In addition, the recognition of future non-exchange transactions as a liability may result in a substantial mismatch between costs and delivery of services to the public.

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?

Response: Consistent with SFFAC 5, we believe that to have a *present* obligation means that the obligation arose as a result of a past transaction or other event and has not yet been settled. Thus, a present obligation should be distinguished from a mere expression of future intent, such as the government's announcement that it intends to acquire equipment. A present obligation is incurred when the government takes a specific action or an event occurs that commits or binds the government.

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?

Response: Please refer to our responses to comments 7 and 8.

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

Response: Please refer to comment 7c.

(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?

Response: Consistent with SFFAC 5, assessments of whether an item meets the definition of an asset, liability, revenue, or expense should be based on conditions that exist at the reporting date, including current law, because all elements of accrual basis financial statements are based on transactions or events that already have occurred. Therefore, if an item meets the definition of an element under the conditions in effect at the reporting date, the power of the government to subsequently change those conditions does not eliminate an element at the reporting date. Conversely, if an item does not meet the definition of an element at the reporting date, the power of the government to subsequently change those conditions does not create the existence of the element at the reporting date. See our previous response to specific matter for comments 6 and 7.

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?

Response: We have not identified additional characteristics that 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?

Response: We have not identified other relevant issues that need to be considered in determining the concept of liabilities.

Specific Matter for Comment 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), or by changes in net assets, defined as resources and obligations, "during" the current period (derived from an asset and liability-led approach)?

Response:
We are concerned that a stringent application of an asset and liability-led approach, using the traditional definitions of an asset and liability, may result in unintended and premature recognition of certain revenues and expenses. The Board's recent Exposure Draft on Phase I of the Conceptual Framework discusses, among other things, user information needs that focus on the importance of revenues and expenses of the government entity for the current period. Also, in practice, standard setting inherently includes a consideration of when it is appropriate to recognize revenues and expenses in the statement of financial performance. In some cases, the timing of revenue or expense recognition may be a primary driver in determining the appropriate standard rather than the recognition of an asset or liability.

It is possible that certain inflows and outflows, for which the Board believes it is not yet appropriate to recognize revenues or expenses, nevertheless do not meet the traditional definitions of an asset or liability. Consequently, if the Board believes that such items currently exist or may exist in the future, the Board should consider either expanding the definition of assets and liabilities to include such items or develop separate elements such as deferred inflows and deferred outflows to report them on the balance sheet. The Governmental Accounting Standards Board (GASB) deliberations might provide useful information to the Board. GASB accounting standards identify two areas (related to derivatives and service concessions) that it considers to be deferred inflows and outflows and is currently analyzing which current balance sheet items do not meet their definition of an asset or liability, but meet their definition of deferred inflows and deferred outflows.

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

Response: See our response to specific matter for comment 11(a) above.

Specific Matter for Comment 12
(a) Should transactions with residual/equity interests be excluded from revenues and expenses?

Response: We have no response to this specific matter.

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

Response: The definitions should be broad enough to cover the range of inflows and outflows generally experienced in the public sector. Consistent with SFFAC 5, we believe that the definitions of revenue and expense should include items that might be reported as gains and losses. Gains and losses should be considered subsets of revenues and expenses, rather than distinct elements, just as capital assets and financial assets are considered subsets of assets.

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?

Response: We have not identified additional characteristics that 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?

Response: We have not identified other issues that need to be considered in determining the definitions of revenues and expenses.

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?

Response:
If the Board determines that deferred outflows of resources and deferred inflows of resources are to become separate elements (see discussion in specific matter for comment 11 above) then they should be clearly articulated and defined.

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?

Response: Consistent with SFFAC 5, we prefer the term net position in the federal government as it is a residual amount. Net position is the arithmetic difference between the total assets (or assets plus deferred outflows) and total liabilities (or liabilities plus deferred inflows) recognized in the federal government's or a component entity's balance sheet. Net position may be positive or negative. We agree with SFFAC 5 that in the federal sector it may not be appropriate to represent the residual net assets of governments as an ownership interest. However, defining net position in this way should not preclude the Board from later developing standards that separately report components of net position. For example, under FASAB standards, earmarked funds are separately reported as a component of net position[2]

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

Response: If the final document covers ownership interests that may exist in the public sector then we believe it would be helpful to users to incorporate the concept of ownership interest, particularly as it relates to GBE's.

(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?

Response: We have not identified other issues that need to be discussed.

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?

Response: We have no comments on this specific matter.

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

[2] Refer to Statement of Federal Financial Accounting Standards 27: *Identifying and Reporting Earmarked Funds for the definition of "Earmark Funds*". FASAB has issued an exposure draft titled "*Revisions to Identifying and Reporting Earmarked Funds: Amending Statement of Federal Financial Accounting Standards 27*"

reporting date based on an assessment of all available evidence; or by basing the approach on the measurement attribute?

Response: We believe the effects of uncertainty (existence and measurement uncertainty) need to be considered. Consistent with SFFAC 5, the Board should consider uncertainty based on the facts and circumstances of the situation using judgment and an assessment of all available evidence.

(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?

Response: See response to specific matter for comment 17(a) above.

Specific Matter for Comment 18
Do you support the use of the same criteria for derecognition as for initial recognition?

Response: We favor the use of the same thresholds for derecognition as those for initial recognition.

Specific Matter for Comment 19
Should the recognition criteria be an integral part of the element definitions, or separate and distinct requirements?

Response: We support separate and distinct requirements. Basic recognition criteria are the conditions an item should meet in order to be a candidate for recognition in the financial statements. FASAB's basic recognition criteria are (a) the item meets the definition of an element of financial statements and (b) the item is measurable.

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