<u>Comments on Exposure Draft 2: Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements</u>

1.	**Specific Matter for Comment 1** Do you agree with the definition of an asset? If not, how would you modify it?	In reviewing the definition of an asset, the following documents were also considered: 1) IPSASB – Key Characteristics of the Public Sector with Potential Implications for Financial Reporting (Exposure Draft April 2011) 2) IASB/FASB – Definition of Assets 3) Exposure Draft 2: Conceptual Framework - Basis for Conclusions (BC3 – BC20) It is our opinion that an IPSASB definition of an asset should reflect the unique characteristics of assets in the public sector, where 'public sector' has been referred to by IPSASB to include "national governments, sub-national governments, local government units and regulatory bodies . . . and Government Business Enterprises (GBEs)". The unique characteristics of the public sector that should be considered are: i) The public sector is expected to deliver goods and services that are not necessarily to generate profits/positive cash flows. ii) There is an obligation for the public sector to provide non-exchange 'social goods' such as welfare services for which any fees charged may not be commensurate with the value of the service provided. iii) A significant proportion of public sector revenue is derived from involuntary non-exchange transactions, mainly taxation; and involuntary transfers governed by treaties and conventions. This gives rise to the issue of a government's capacity to generate the revenue required to meet its

		obligations through non-exchange transactions. iv) A significant portion of property, plant and equipment held in the public sector are for the welfare of citizens as well as future economic benefits. v) A significant portion of government assets are specialized in nature (e.g. roads and heritage assets) with a very limited market for their sale. This gives rise to issues of measuring such assets. vi) The date of the 'past event' that gave rise to the asset may not be clear. It is our view that the unique characteristics described at i) – vi) above are not reflected in the ED, which defines an asset as "*a resource, with the ability to provide an inflow of service potential or economic benefits that an entity presently controls, and which arises from a past event."* This definition is similar to the IASB definition that mainly applies to the private sector/non-governmental entities, which states, "*An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity*." The key features of an asset from these definitions are: a) past event; b) control; and c) future economic benefits, which are not completely relevant to the public sector based on its unique characteristics described at i) – vi) above. A relevant and robust definition of an asset could be: "A *resource, with the ability to provide* ***social*** *or economic benefits that an entity presently controls, and which arises from a* ***probable/an identifiable*** *past event."* IPSASB defines a liability 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*". ***NB: Social – welfare, recreational, charitable.***

	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?	In our opinion, this definition is generally relevant to the public sector. However, the use of the controversial term 'past event' raises a similar concern of the difficulty to clearly establish the date of its occurrence as seen in the definition of an asset. I support the proponents referred to at BC27 to the ED's Basis for Conclusions that believe that "identification of a past event is not an essential characteristic of a liability . . . there may be many possible past events and that establishing the key past event is likely to be arbitrary". The opposing view that "identifying the key past event is necessary to determining when public sector liabilities should be recognized" is also acknowledged. Since the present obligation should be linked to an occurrence in the past, I believe that 'prior binding commitment' would be a narrower and less arbitrary reference point than 'past event', which would amend the definition to read: "A liability is *a present obligation that arises from a* **prior binding commitment** *where there is little or no realistic alternative to avoid an outflow of service potential or economic benefits from the entity*". We believe that the description of non-legal binding obligations is clear and does not require modification.
2.	**Specific Matter for Comment 3** Do you agree with the definition of revenue? If not, how would you modify it?	NO. a) Modify the wording of the definition to focus on changes in assets and liabilities instead of current period flows. b) Exclude 4.1. (b) c) Explicitly include verbiage that clarifies how gains are treated per Section 4 of Basis of Conclusions, clause BC38. NO. a) Modify the wording of the definition to focus on changes in assets and

	Specific Matter for Comment 4 Do you agree with the definition of expenses? If not, how would you modify it?	liabilities instead of current period flows. b) Exclude 4.2 (b) c) Explicitly include verbiage that clarifies how losses are treated per Section 4 of Basis of Conclusions, clause BC38. The definition for these seminal elements of financial statements as provided in this conceptual framework differs in key respects from that already promulgated by the IAASB in its Conceptual Framework for Financial Statements 2010 (CFFFS 2010). To some degree this is due to the differing nature of the entities concerned, i.e., public sector vis-à-vis commercial enterprises. The differences are: a) The treatment of revenue and expenses as current period flows is I think particularly apt for the public sector environment, but it does however, have the concomitant difficulties which arise when there is the need to consider the impact of deferral of these flows. As deferred flows are a significant issue in the public sector, for clarity it might be advisable to couch these definitions from the perspective of changes in assets and liabilities. b) Use in the definition of revenue and expense of the term "net assets of an entity" rather than "equity" as in CFFFS 2010. This difference is cosmetic as the two terms mean essentially the same thing. However, I believe "net assets of an entity" is more meaningful in a public sector context. c) Expansion of these definitions to account for current reporting period deferred inflows and outflows, respectively. This takes the definition of revenue and expenses beyond that already outlined in CFFFS 2010 and results in an accounting treatment that is counter-intuitive to accepted practice which treats deferred inflows and outflows as impacting assets and liabilities rather than revenue and expense. Section 1.6 of this very framework outlines

		exact same position. It is and will therefore be, I believe confusing to the average user of financial statements for such a radical shift in accepted classification to be used. I am therefore inclined to agree with the Alternative View of Prof. Mariano D'Amore that deferred outflows and inflows should be separated from revenue and expenses, see AV 4, page 34. Such a treatment is also in keeping with Government Accounting Standards Board (GASB) 63. Finally, gains and losses are not considered conceptually different from revenue and expenses and are therefore not separately defined. This position is detailed in Basis for Conclusions, section 4, clause BC 38. It would however be good to include this as part of the Conceptual Framework explicitly
3.	**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? 4 (ii) Definitions of deferred inflows and deferred outflows? If not, how would you modify them?	a) An element is a broad aggregation of economic transactions that make sense to the users of financial reports, that is, it helps to improve accountability and decision making. The ED identifies eight elements: 1. Assets 2. Liabilities 3. Deferred Inflows 4. Deferred Outflows 5. Ownership Contributions 6. Ownership Distributions 7. Revenues 8. Expenses. Elements 1 through 4 combine to yield the Net Financial Position of the entity, which under this framework is Net Assets adjusted to include the net effect of Deferred Inflows and Deferred Outflows. The ED asks if deferred inflows and deferred outflows deserve to be elevated to the position of elements in the Statement of Financial Position.

		What are deferred inflows and deferred outflows? In essence, these are non-exchange transactions (more likely to be found in public sector or not-for-profit entities) that generate service potential or economic benefit in a specified future financial period. In a non-exchange transaction, one party does not expect to derive benefits that are commensurate with the value delivered, as in a donation or a grant of funds or an advance payment of taxes (unlikely in the Jamaican public sector environment). Because, by definition, the benefit to be generated by the recipient does not arise until some future period, the entity receiving the value would not classify the transaction as “revenue” in the current reporting period but as “deferred inflows”. Note, of course, that under the double entry system, the funds received would be classified as an asset, that is, “a resource that an entity presently controls capable of generating service potential or economic benefit, and which arises from a past event”. In this regard, the representation of the transaction as a “deferred inflow” indicates how much of the organization’s assets are reserved for financing spending in the future at which time the deferred inflows will be reported as revenues. On the other hand, the entity delivering the value would classify the transaction under the element “deferred outflow” and would delay reporting it as an expense until the specified future financial period(s). If one accepts that in the circumstances outlined above, the inflows should not be recognized as revenues in the books of the receiving entity, nor the outflows as expenses in the books of the donor entity as they do not affect the amount available for spending in the current reporting period, one question to be posed is, “why can they not be subsumed under the elements “liabilities” and “assets”? The argument is that in public sector entities, there is (or could be) a prevalence of

		non-exchange transactions, and reporting them as deferred inflows and deferred outflows under liabilities and assets would be misleading to the user's interpretation of the change in net assets (and therefore the change in the Owner's financial position) as these deferred flows are not available for use by the entity at the date of the statement. In our opinion, it is difficult to see how the introduction of these two new elements improves the understanding of financial statements when the effect of the deferred inflows/outflows will typically be reported as an increase/decrease in Assets (bank balance) unless the intention is to report the change in separate lines or new elements as "*funds held for future spending*"/ "*funds to be applied to future spending*". It is our opinion that the introduction of the elements "deferred inflows" and "deferred outflows" in financial reporting, even in public sector accounting, will serve to confuse users grown accustomed to the concept of "net assets" as representing the Owner's equity especially in circumstances where the value of non-exchange transactions may not be material. Our preference would be to introduce a statement akin to the Statement of Comprehensive Income to incorporate the deferred flows below the Net Surplus line (Revenues less Expenses) while maintaining the integrity of the Statement of Financial Position with bank and other cash balances that reflect resources held by the entity even if control is theoretically absent or arise from obligations that are not present obligations. For completeness, the Statement should show *Funds held for future spending* in a separate line under Assets and F*unds to be applied to future spending* in a separate line under Liabilities with appropriate note disclosures.
4.	**Specific Matter for Comment 6** (a) Do you agree with the terms net	(a) No.

	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?	Following the comments on specific matter 5 above, deferred inflows and deferred outflows should be excluded from the definitions on net assets and net financial positions. ***Definition*** -"Net assets is the difference between assets and liabilities." **a)** The term net assets could be described in more detail as per the draft exposure to give consideration to some of the major elements such as : • the underlying assumption to assist in identifying and to determine the transaction which gives rise to an asset or a liability • The determination which would give rise to the offset, that is, the "right of offset "which leads to the principle that the items are of the same type for offset. • That the benefits derived are comparable and the flows are within the same time period. This is important also when the distinction is being made between net financial positions. Or otherwise reference is to be made to the detail definition and distinction. b) & c) - the decision to define the ownership contribution and ownership distribution is very important – i.e. subsidiary, quasi subsidiary, etc... As this can have a significant impact on the asset and liabilities e.g. Such as sale of a subsidiary etc. c) The definition could elaborate to incorporate mergers, consolidation, etc. of government entities. d) The ownership interest should be defined in this conceptual framework as it matters how one would treat with the asset or liability – off balance sheet reporting , disclosure notes or would such ownership interest directly be

	Specific Matter for Comment 7 Do you agree with the discussion on recognition? If not, how would you modify it?	reflected in the net asset or the net financial position. The ownership interest can impact significantly the net asset or net financial position and so should be defined within the conceptual framework. (b) Proposing that the question be adjusted to read: Should ownership contribution and ownership distributions be regarded as elements of your financial statements? As a result the answer would be yes and the definition would be agreed on.

Exposure Draft 3: Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: **Measurement of Assets and Liabilities in Financial Statements**

1.	**Specific Matter for Comment 1** Do you agree that the selection of a measurement basis should be based on the extent to which a particular measurement basis meets the objectives of financial reporting? If you think that there should be a measurement objective please indicate what this measurement objective	The selection of a measurement basis should be based on the extent to which a particular measurement basis meets the objective of financial reporting. The measurement objective should be based on a current measurement value. Where Net Selling Price is relevant, in most cases it will be adequately representationally faithful, verifiable and comparable between entities and should be the measurement of choice. Assessments of Net Selling Price are likely to be straightforward to obtain and provide understandable, verifiable information capable of being produced in a timely manner. Since the measurement is based on observable market value it is likely to provide information that is comparable between entities.

	should be and give your reasons.	Value in use would be relevant to assessments of impairment and other limited relevant cases.
2.	**Specific Matter for Comment 2** Do you agree with the current value measurement bases for assets that have been identified in Section 3? If not, please indicate which additional measurement bases should be included or which measurement bases should not be included in the Framework?	
3.	**Specific Matters for Comment 3** Do you agree with the approaches proposed in Section 4 for application of: (a) The fair value measurement model to estimate the price at which a transaction to sell an asset would take place in an active, open and orderly market at the measurement date under current market conditions. If not, please give your reasons; and	The fair value model measurement basis for an asset is the amount for which the asset can be sold for in an active, open and orderly market at the measurement date under current market conditions. In other words, there must be a specific market for the assets. The model is predicated on certain assumptions: 1. The asset will be used in its highest & best use, taking into account physical characteristics and uses that are legally permissible and financially feasible. 2. The transaction takes place in the principal and most advantageous market for the asset. 3. The most appropriate valuation techniques are used which considers assumptions market participants will use when pricing the asset. We do not agree with this measurement basis because the assumptions appear to be impractical for non-financial assets. The first assumption implies the optimal efficiency of the asset, which is dependent certain factors. For instance, availability of competent staff to put the machinery to

	(b) The deprival value model to select or confirm the use of a current measurement basis for operational assets. If not please give your reasons.	use, training costs associated with raising the capacity of staff, is there a market for the end product, the economic climate may affect maintenance/servicing of machinery, the remaining useful life of the asset also impacts on the optimal use. The second assumption of the transaction taking place in the principal & most advantageous market may be difficult to assess. In the principal and most advantageous market, there is likely to be many competitors i.e. entities that may be in the same line of business. This may impact on the price an organization is willing to pay. Determining the most appropriate valuation technique based on assumptions made by market participants seems as if it is going to be a subjective process. Additionally, the model excludes transaction costs in selling an asset. The proceeds of the sale will therefore seem more because it did not reflect costs which will be associated with the sale of the asset.
4.	**Specific Matter for Comment 4** Do you agree with the proposed measurement bases for liabilities in Section 5? If not, please indicate which additional measurement bases should be included or which measurement bases should not be included in the Framework?	a. Historical cost: Liabilities are recorded at the amount of proceeds received in exchange for the obligation or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business. Discussion: This is a very practical measurement bases, notwithstanding the limitations of not being able to be applied for liabilities that do not arise from a transaction, such as a liability to pay damages for a tort or civil damages or in situations in which the liability vary in amount such as defined benefit pension liabilities.

b. Market value: this refers to trading in a competitive auction setting. Market value is often used interchangeably with *open market value*, *fair value* or *fair market value*, although these terms have distinct definitions in different standards, and may differ in some circumstances.

Discussion:

This seems more appropriate in a situation where there would be a third party who would accept the liability being transferred to him. (Believed that it would be much more than the actual amount outstanding)

However, because it is extremely unlikely that there will be an open, active and orderly market for liabilities, this is the only one I think that could be out.

c. Cost of release: the amount to which to exit from an obligation e.g. that which is contained in an agreement such as cancellation clause.

Discussion:

This could involve cash transaction in which there may be a discount if there is an (immediate exit from the obligation) in comparison to a credit situation where a premium would be charged by the third party to (accept the transfer of the liability from the obligator). Not aware that there is so much flexibility with public entities.

d. Assumption price: "the amount which the entity would rationally be willing to accept in exchange for assuming an existing liability"

Discussion:

This is similar to "**cost of release"** i.e. the amount that a third party would charge to

		accept the transfer of the liability from the obligator. e. Cost of fulfillment: Discussion: Appears to mean that the entity could end up paying more than what was originally agreed. However, based on the operations of Gov. Entities, this would only be practical in situations in which the estimates or prices are quoted in foreign currency and or being imported, thus the cost of fulfillment could be different from the estimated price. **<u>Conclusion</u>** There would be the need to look at how the liabilities were incurred / created by the entities and consider the uniqueness of the operations of government entities in terms of procurement process. In a commercial company, all would be appropriate. The measurement bases as they are capture the many possibilities. However, the appropriate measurement bases are highly dependent on how the transaction was created and the authority of the entity which will have to settle the obligation.