

Meeting: IPSASB Consultative Advisory Group
Meeting Location: Abu Dhabi, United Arab Emirates
Meeting Date: December 9, 2019

Agenda Item 6

For:
☐ Approval
☒ Discussion
☒ Information

LIMITED SCOPE REVIEW OF THE CONCEPTUAL FRAMEWORK

Project summary	<p>The aim of the Limited Scope Review of the Conceptual Framework project is to make amendments to The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities. These amendments will arise from two drivers:</p> <ul style="list-style-type: none"> (i) IASB developments (ii) IPSASB experience in using Framework <p>The purpose of this paper is to consider the project's scope, in order to inform a project brief that will be considered by the IPSASB in March 2020.</p>	
Meeting objectives	Obtain views of CAG to inform the development of a project brief for discussion at the IPSASB's March 2020 meeting.	Agenda Item
Discussion Items	<p>CAG input into issues identified</p> <ul style="list-style-type: none"> • Drivers for the project. • Issues that should be addressed in the project. 	6.1
Other supporting items	IPSASB Due Process Checklist (condensed to include portions relevant to the CAG).	6.2

Background

1. [The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities](#) (the IPSASB Framework) was approved in September 2014 and issued in October 2014. Publication of the Framework filled a major gap in the IPSASB's literature. Until approval of the Conceptual Framework the IPSASB had been implicitly reliant on the former International Accounting Standards Committee's (IASC) *Framework for the Preparation and Presentation of Financial Statements*, which was published in 1989 and was adopted by the International Accounting Standards Board (IASB) in April 2001.
2. On approval in September 2014 the IPSASB decided not to commit to a review of the Framework. This was largely because the IPSASB wanted to allow the Framework to bed down for a significant period, rather than suggesting that it would be amended even before it was published.
3. In 2018, after having been applied in standards development for over three years the IPSASB considered that a limited scope review of the Framework would be appropriate. This view was reinforced by the fact that the IASB was shortly to issue its finalized Framework. It therefore proposed such a project in its Strategy and Work Plan Consultation in 2018 because there had been developments in the IASB's Conceptual Framework, which should be evaluated for relevance to the public sector. The proposed project received significant support from respondents for the reasons outlined by the IPSASB and is one of two projects that the IPSASB committed to initiate in the 2019–2020 period – the other was Natural Resources, which the CAG considered at its June 2019 meeting.

Issue 1: Drivers for the Project

4. There are two drivers for the project:
 - (a) Developments in the International Accounting Standards Board's (IASB's) revision of its Conceptual Framework after September 2014.
 - (b) Experience in using the Conceptual Framework in developing new pronouncements and maintaining existing IPSAS since approval in September 2014.
5. In evaluating the potential issues for inclusion within the scope of the project the criteria for project prioritization have been used where appropriate. These are :
 - Prevalence
 - Consequences
 - Urgency
 - Feasibility

The analysis particularly emphasizes the urgency criterion. Staff consider that all the potential changes from the issues discussed in the following sections are feasible, although any review of 'other resources' and 'other obligations' may be resource intensive (see below paragraphs 21–23).

IASB Drivers

6. The IASB issued its revised *Conceptual Framework for Financial Reporting* (IASB Framework) in March 2018, replacing the previous version issued in 2010. The revised IASB Framework became effective immediately for the IASB and the IFRS Interpretations Committee.¹
7. There were a number of developments in the finalization of the IASB's Framework and, in the case of materiality, after finalization, that post-dated September 2014. These were primarily but not limited to:
 - (i) The finalized Measurement chapter was considerably modified following comments on the 2013 Discussion Paper, *Reviewing the Conceptual Framework* (paragraph 8);
 - (ii) The definitions of the elements were finalized (paragraphs 9-10);
 - (iii) The chapter on the Qualitative Characteristics (QCs) of Useful Financial Information acknowledged prudence in the context of neutrality in the QC of faithful representation (paragraphs 11–13); and
 - (iv) The IASB's Annual Improvements 2018 project amended the guidance on materiality as a consequence to changes to the definition of materiality in IAS 1, *Presentation of Financial Statements* and IAS 8, *Accounting Policies, Changes to Accounting Estimates and Errors* (paragraph 14).

Measurement Chapter

8. The finalized IASB Measurement chapter was restructured from that outlined in the IASB's 2013 Discussion Paper. This new structure brought the IASB approach closer to IPSASB, although there are important differences. Unlike the IASB Framework, the IPSASB Framework explicitly includes a measurement objective linked to the provision of information on operational capacity, financial capacity and the cost of services, whereas the IASB Framework has a section on 'Factors to Consider When Selecting a Measurement Basis.' The IASB Framework included sections on the measurement of equity and cash-flow based measurement techniques, neither of which were considered in the IPSASB Framework. The most significant difference is that the IASB Framework includes fair value as a current value, whereas the IPSASB Framework includes market value. This urgent issue is discussed in further detail in paragraph 23 below.

Elements

9. The IPSASB Framework defines an asset, a liability, revenue, expense, contributions from owners and contributions to owners. The IASB Framework defines an asset, a liability, equity, income and expenses. Staff does not propose that there are additions or deletions to the current elements in the IPSASB Framework.
10. Staff's preliminary view is that the differences between the definitions of an asset and a liability in the two Frameworks are not substantive. However, it is important that this view is tested for consequences that are not immediately apparent, e.g., does a present obligation of the entity for an outflow of resources (IPSASB) differ from a present obligation of the entity to transfer an economic resource (IASB). The difference in the definitions of income (IASB) and revenue (IPSASB) and

¹ 1. The IASB Framework has an effective date of January 1 2020—with earlier application permitted—for entities that use it to develop accounting policies when no IFRS Standard applies to a particular transaction.

expenses (IASB) and expense (IPSASB) are attributable to IPSASB's acknowledgement of other economic phenomena—other resources and other obligations (see below paragraphs 24–26).

Acknowledgement of prudence in context of neutrality

11. The core text of the IPSASB Framework does not refer to prudence. The Basis for Conclusions notes that some respondents to the ED on *Role and Authority, Objectives, QCs and the Reporting Entity* had expressed concern that prudence was not identified as a QC and felt that its importance was insufficiently recognized or explained. The IPSASB concluded that 'prudence was reflected in the explanation of neutrality as a component of faithful representation(and) therefore....prudence is not identified as a separate qualitative characteristic because its intent and influence in identifying information that is included in GPFRs² is already embedded in the notion of faithful representation.'
12. Following representations from constituents, in particular from Europe, and considerable discussion, the IASB Framework acknowledges that 'neutrality is supported by the exercise of prudence' and that 'prudence is the exercise of caution when making judgments under conditions of uncertainty.' The IASB Framework goes on to state that the exercise of prudence does not lead to overstatements or understatements or overstatements of assets, liabilities, revenue or expense. Furthermore, the exercise of prudence does not imply the need for asymmetry, although particular standards may contain asymmetric requirements.
13. The staff view is that the consequences of these changes are not particularly far-reaching. Nevertheless, there are strongly held views on prudence. For example, prudence has been emphasized by some members of the European Public Sector Accounting Standards (EPSAS) Working Group.

Materiality

14. The IASB's 2018 Improvements Project made amendments to IAS 1 and IAS 8, to clarify the definition of material to resolve difficulties that entities experience in making materiality judgements when preparing financial statements and to align the definitions in both standards. Because of these changes the IASB also amended Chapter 2 of its Framework. The IPSASB considered including these amendments in its 2019 Improvements project but decided that they should be initially considered in the Limited Scope Review. In Staff's view there is some urgency to this issue from both an alignment perspective and because materiality is a pervasive issue in the public sector.

Other issues related to IASB Framework

Capital maintenance, unit of account and executory contracts

15. Although not new developments as they reaffirmed previous approaches the finalized IASB Framework included subsections on:
 - Capital Maintenance
 - Unit of Account
 - Executory Contracts

² General Purpose Financial Reports

The IPSASB Conceptual Framework does not include equivalent sections. As noted above, unlike the IASB Conceptual Framework, the chapter on Measurement includes an objective of measurement:

“To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account and for decision-making purposes.”

16. It was considered that in light of this objective a section on capital maintenance was unnecessary and that the section in the IASB's 2010 Framework, which dated back to the IASC's 1989 Framework, was not easily oriented to the public sector. Recent discussion of financial performance in the public sector has suggested that this view should be reassessed, because capital maintenance is fundamental to assessments of financial performance.
17. Unit of account was considered a standards-level issue and there were reservations about including a section in the IPSASB Framework. However, the importance of decisions on the unit of account has been highlighted in both the Financial Instruments and Revenue projects and there is certainly a case for some high-level guidance. Similarly, the IPSASB did not include any guidance on executory contracts. This was because of a view that inclusion might have had unforeseen consequences for the Social Benefits project. With the delivery of IPSAS 42, *Social Benefits* earlier this year and the approval of the *Application Guidance on Collective and Individual Services* at the September 2020 meeting this risk no longer exists. The issues of unit of account and executory contracts are prevalent in the public sector.

Hierarchy of QCs: Fundamental and Enhancing

18. Unlike the IASB the IPSASB decided not to distinguish fundamental and enhancing QCs. In a 2010 revision the IASB characterized relevance and faithful representation as fundamental, and understandability, timeliness, comparability, and verifiability as enhancing. It is questionable whether information, which is not faithfully representative or relevant, provides information that is useful for accountability and decision-making purposes, even if it is understandable, timely, comparable and verifiable. Therefore, the IPSASB Framework is arguably flawed. However, while this issue could be addressed relatively straightforwardly it does not seem to have caused problems in practice.

IPSASB Drivers

19. The main issues that have arisen in application of the IPSASB Framework are:
 - There is no definition of fair value; project work has demonstrated that an exit and orderly market-based current value is necessary, particularly in accounting for financial instruments (paragraphs 20–22);
 - The relationship between fair value, as defined in IFRS 13, *Fair Value*, and market value as defined in the IPSASB Framework is unclear (paragraph 23);
 - The need for 'other resources' and 'other obligations' may be questionable given the IPSASB's decision not to deploy them at standards level in the Revenue project (paragraphs 24–26); and
 - It is questionable whether the term 'non-legally-binding obligation' rather than 'constructive obligation' has actually made the discussion of present obligations, which give rise to liabilities more understandable (paragraph 27).

Fair value

20. IFRS 13, *Fair Value*, was issued in 2013 with a revised definition of fair value that was explicitly exit-based. In its Conceptual Framework Exposure Draft on Measurement issued in 2013 IPSASB did not propose a fair value measure. A number of respondents challenged the lack of an exit-based market derived current value and advocated adoption of fair value, as defined in IFRS 13³.
21. The IPSASB decided to define 'market value'⁴ using the pre-IFRS 13 definition of fair value and also to define replacement cost as a measure in its own right, rather than as an estimation technique for fair value. The rationale was that market value could be used for both entry and exit-based transactions and that replacement cost would be appropriate for specialized public sector assets. Recently, the Financial Instruments project and the Measurement project have demonstrated the flaw in this rationale and the need for an exit-based current value reflecting an orderly market.
22. Earlier this year the [Consultation Paper, Measurement](#) proposed the importation into the IPSASB literature of fair value as defined in IFRS 13. A number of CAG members have stressed that, from a public interest perspective, it is very important that any fair value definition corresponds to the IFRS 13 definition. Furthermore, it is essential that the Measurement project and the Conceptual Framework move in step on this issue. For these reasons this is an urgent issue.

Relationship between fair value and market value

23. Following from the above background and analysis the relationship between fair value and market value must be clarified. The rationale for the inclusion of market value in the Framework is that, as an entry and exit value, it is an appropriate measurement basis for non-specialized operational assets. This could have been stated more clearly. There are questions whether both market value and fair value are needed in IPSASB's literature and what the practical consequences are of having two similar measurement bases.

Other resources and other obligations

24. One of the most controversial features of the IPSASB Framework was the assertion that "in some circumstances to ensure that the financial statements provide information that is useful for a meaningful assessment of the financial performance and financial position recognition of economic phenomena that are not captured by the elements does not preclude IPSAS from requiring or allowing the recognition of resources or obligations that do not satisfy the definition of an element." Such phenomena were described as 'other resources and 'other obligations.' The IPSASB had at an earlier stage of the project decided not to proceed with deferred assets and deferred liabilities as elements following comments on the Framework ED on Elements.
25. Although not explicitly linked to revenue recognition most of the discussion on 'other resources' and 'other obligations' during the development of the Framework focused on transfers of resources with what were known misleadingly as 'time requirements'⁵ - transfers without conditions but where the resource provider indicated the reporting periods over which the resources were expected to be

³³ Fair value is the price that would be received to sell an asset, or paid to transfer a liability in an orderly transaction between market participants at the measurement date

⁴ Market value for assets is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

⁵ The IPSASB decided in December 2018 to no longer use the term 'time requirements'.

used. According to IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, revenue from such transactions is recognized as receivable. Some preparers, especially international organizations, considered that this accounting treatment overstated revenue in the reporting period in which it was recognized and did not faithfully represent the financial performance and financial position of an entity. This was felt to be confusing to senior management and other users of the financial statements.

26. In December 2018, the IPSASB decided not to deploy other resources and other obligations in the Revenue project. The IPSASB reaffirmed that resources received with no binding arrangements are recognized as revenue on Day One. The IPSASB's decision may suggest that there is a case for removing other resources and other obligations from the Framework. This would allow the IPSASB definitions of revenue and expense to more closely align with IASB equivalents. A countervailing view is that this is just one issue, albeit a major one, and that proposing modifications to the Framework is an over-reaction. It is also notable that the EPSAS Conceptual Framework does include 'other economic phenomena', largely for legal reasons.

Non-legally-binding obligation'

27. In the Framework the IPSASB decided to use the term 'non-legally binding obligation', rather than the term 'constructive obligation'. While the latter term was embedded in standard-setting literature and had been used in IPSASB standards the Basis for Conclusions stated that the term had been difficult to interpret and apply in a public sector context. The term 'non-legally binding obligation' has not been introduced into IPSASB's standards-level literature. It seems questionable whether the term is any clearer than 'constructive obligation'.

CAG Question 1:

CAG views are requested on the identified project drivers? Are there any additional drivers from a public interest perspective that the IPSASB should consider?

Issue 2: Identifying urgent issues for inclusion in project scope

28. As its title implies the planned review of the IPSASB Framework is not intended to lead to a major overhaul of the Framework. It is therefore necessary to focus on particular issues. While all the above issues are significant in varying degrees, not all are urgent. The following table analyzes the issues identified above and gives a staff view of their status – whether an issue is urgent, significant or less significant. Staff's view is that urgent issues should definitely be within the scope of the project. Significant issues might be within the scope, subject to Board and staff capacity. The one issue classified as less significant should not be addressed in the project.

<i>Issue</i>	<i>Status</i>	<i>Comments</i>
Review of Measurement Chapter.	Urgent	Important to consider whether IPSASB should pick up any of analysis in areas such as cash-flow based measurement techniques.

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<i>Issue</i>	<i>Status</i>	<i>Comments</i>
Definitions of Elements.	Urgent	Unforeseen consequences can result from minor differences between IASB and IPSASB definitions. It is in the public interest for global standard setters to be as aligned as feasible.
Acknowledging Prudence.	Urgent	No evidence that the absence of 'prudence' in the chapter on QCs has had adverse consequences, but it is an issue of significant regional significance with implications for IPSAS adoption and implementation and therefore of public interest.
Materiality	Urgent	Materiality continues to be a major implementation issue despite numerous efforts to emphasize its importance e.g. the 2017 Staff Q & A on Materiality . The amendments to the IASB's Framework provide accessible guidance on how materiality considerations can be applied. In particular there is a welcome assertion that the understandability of the financial statements might be impaired if material information is hidden by immaterial information.

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<i>Issue</i>	<i>Status</i>	<i>Comments</i>
Capital Maintenance, Unit of Account and Executory Contracts.	Significant	<p>Inclusion of sections on these topics would increase alignment with the IASB Framework. but questionable whether unit of account and executory contracts are a priority.</p> <p>A renewed focus on the meaning of financial performance in the public sector will require consideration of capital maintenance.</p>
Hierarchy of QCs: Fundamental and Enhancing.	Significant	<p>Suggesting that information that is not faithfully representative or relevant is useful and supports the objectives of financial reporting if it is timely, verifiable, comparable or understandable might be used to support questionable accounting treatments not in public interest.</p> <p>However, no obvious examples of adverse effects on IPSASB standard setting have been identified by staff.</p>
Need for fair value definition.	Urgent	<p>Linked to Review of Measurement Chapter. Clear need for an IFRS 13-based definition of fair value in IPSASB literature.</p> <p>Also essential that the Measurement chapter is in step with Measurement project. Consultation Paper, <i>Measurement</i>.</p>

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<i>Issue</i>	<i>Status</i>	<i>Comments</i>
Relationship between market value as defined in Framework and fair value as defined in Measurement project and drawn from IFRS 13, <i>Fair Value</i> .	Urgent	<p>Need to consider whether market value should be retained in light of decision in Measurement project to adopt fair value as defined in IFRS 13.</p> <p>The ambiguity about the relationship between market value and fair value has potential downstream consequences for IPSAS implementers and needs to be addressed urgently.</p>

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<i>Issue</i>	<i>Status</i>	<i>Comments</i>
Other resources and other obligations	Less significant (and inappropriate for this type of project.)	<p>While other resources and other obligations have not been used at standards-level their presence in the Framework gives the IPSASB some flexibility in future. Questionable whether their continued inclusion in the Framework is causing problems. Proposing change on the basis of one Board decision, albeit a very important one, is arguably an over-reaction.</p> <p>Also notable that EPSAS Conceptual Framework includes similar items.</p> <p>This is a major topic, which during the development of the Elements chapter of the IPSASB Framework required significant staff and member resources and considerable Board meeting time. Staff consider it inappropriate for a limited scope review.</p> <p>It is acknowledged that the reflection of other resources and other obligations in the Framework does mean that definitions of revenue and expense are not aligned with their IASB counterparts.</p>

<i>Issue</i>	<i>Status</i>	<i>Comments</i>
Hierarchy of QCs: Fundamental and Enhancing	Significant	<p>Suggesting that information that is not faithfully representative or relevant is useful and supports the objectives of financial reporting if it is timely, verifiable, comparable or understandable might be used to support questionable accounting treatments not in public interest.</p> <p>However, no obvious examples of adverse effects on IPSASB standard setting have been identified by staff.</p>
Use of non-legally binding obligations	Less Significant	Probably best to monitor rather than proposing changes at present.

CAG Question 2:

What are the CAG views on the the above staff proposals? Are there other issues that should be prioritized from a public interest perspective?

Appendix A: IPSASB Due Process Checklist (condensed to include portions relevant to the CAG)

Project: Limited Scope Review of Conceptual Framework

#	Due Process Requirement	Yes/No	Comments
A. Project Brief			
A1.	A proposal for the project (project brief) has been prepared, that highlights key issues the project seeks to address.	Pending	The views of the CAG are sought in order to inform the development of a project brief for the IPSASB's March 2020 meeting.
A2.	The IPSASB has approved the project in a public meeting.		
A3.	The IPSASB CAG has been consulted on the project brief.		
B. Development of Proposed International Standard			
B1.	The IPSASB has considered whether to issue a consultation paper or undertake other outreach activities to solicit views on matters under consideration from constituents.		
B2.	If comments have been received through a consultation paper or other public forum, they have been considered in the same manner as comments received on an exposure draft.		
B3.	The IPSASB CAG has been consulted on significant issues during the development of the exposure draft.		
D. Consideration of Respondents' Comments on an Exposure Draft			
D4.	The IPSASB CAG has been consulted on significant issues raised by respondents to the exposure draft and the IPSASB's related responses.		
D5.	Significant comments received through consultation with the IPSASB CAG are brought to the IPSASB's attention. Staff have reported back to the IPSASB CAG the results of the IPSASB's deliberations on those comments received from the CAG.		