

Meeting: IPSASB Consultative Advisory Group
Meeting Location: Virtual Meeting
Meeting Date: December 7, 2020

Agenda Item 4

For:
 Approval
 Discussion
 Information

NATURAL RESOURCES

Project summary	The objective of the natural resources project is to develop a Consultation Paper, then one or more Exposure Drafts to address the issues relating to the recognition, measurement, presentation and disclosure of natural resources.	
Meeting objectives	Topic	Agenda Item
Discussion Items	Recognition of the Sovereign Power to Issue Exploration Licenses as an Asset	4.1
Other supporting items	Appendix A: IPSASB Due Process Checklist (condensed to included portions relevant to the CAG)	4.2
	Appendix B: Links to Other Documents	4.3

Recognition of the Sovereign Power to Issue Exploration Licenses as an Asset

Background

1. At the September 2020 IPSASB meeting, the staff presented a paper ([see Agenda Item 10.2.1](#)) on whether a government's sovereign power to issue exploration licenses for subsoil resources, in and of itself, could be recognized as an asset under IPSAS.
2. The intention of the IPSASB paper was to apply asset recognition concepts from the IPSASB's Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the Conceptual Framework) and reaffirm the IPSASB's conclusions in the context of the sovereign power to issue exploration licenses.
3. The key points of the paper were as follows:
 - (a) To be recognized as an asset under IPSAS, the sovereign power to sell exploration licenses must satisfy the definition of an asset and be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in General Purpose Financial Reports.¹
 - (b) To meet the definition of an asset as defined in paragraph 5.6 of the Conceptual Framework, the sovereign power must be a *resource* presently *controlled* by the entity as a result of a *past event*.
 - (c) Paragraph BC5.18 of the Conceptual Framework states that, in general, a government's inherent powers do not give rise to the recognition of assets until these powers are exercised and subsequent rights exist to receive service potential or economic benefits. Paragraph 5.13 of the Conceptual Framework elaborated on this concept, stating the following events may be considered in assessing when an entity's control of rights to resources arises:
 - (i) A general ability to establish a power,
 - (ii) Establishment of a power through a statute,
 - (iii) Exercising the power to create a right, and
 - (iv) The event which gives rise to the right to receive resources from an external party.
 - (d) Applying paragraph 5.13 to the context of the power to issue and sell exploration licenses, such power would not meet the definition of an asset until it has been exercised through the establishment of a legal framework to issue licenses, and a license has been sold in accordance with the legal framework.
4. The IPSASB agreed with the staff and Natural Resources Task Force's recommendation that a government's sovereign power to issue exploration licenses, in and of itself, does **not** meet the definition of an asset and would therefore not be considered for recognition under IPSAS.
5. As part of their instructions to staff, the IPSASB instructed the staff to clarify the distinction between the sovereign power, or the ability, to issue licenses and the transaction of issuing licenses,

¹ Conceptual Framework, paragraph 6.2.

and include a more detailed consideration of when an asset could exist and be recognized.² The IPSASB suggested to make use of a timeline from the establishment of a framework to actual issuances of licenses to illustrate the points in time in which *any* asset (e.g., binding arrangement asset, accounts receivable, or a sovereign power asset, if possible) could be recognized. The inclusion of the other assets in the timeline is meant to illustrate the distinction between the sovereign power to issue licenses and the actual issuances of licenses when they occur. This paper summarizes the staff's proposed approach to address the above IPSASB instruction regarding sovereign powers.

6. The recognition of sovereign powers has long been debated in the public sector. In addition, because of the current COVID-19 pandemic, governments which are under fiscal pressure may be incentivized to sell assets to raise funds. Natural resources, as well as the rights to develop, extract, and sell these resources, may be an area where governments are looking to make windfall gains.
7. As a result, the CAG is asked to provide their views on the public interest aspects of the proposed approach and advise on whether the proposals are helpful for constituents to understand the IPSASB's conclusion.

Proposed Approach to Address the IPSASB's Instruction

8. The staff plans to include the discussion on recognition and past event from the September 2020 IPSASB meeting, as summarized in paragraph 3 above, in the CP. To supplement the discussion and to clarify the distinction between the ability to issue licenses and the actual transaction of issuing licenses, the staff propose to add the following example and timeline to the analysis to illustrate when an item can be recognized as an asset.

Example

A government entity plans to exercise its sovereign powers to establish a legal framework to issue exploration licenses to unrelated entities. Prior to the establishment of this framework, there is no legal mechanism for the government entity to issue exploration licenses.

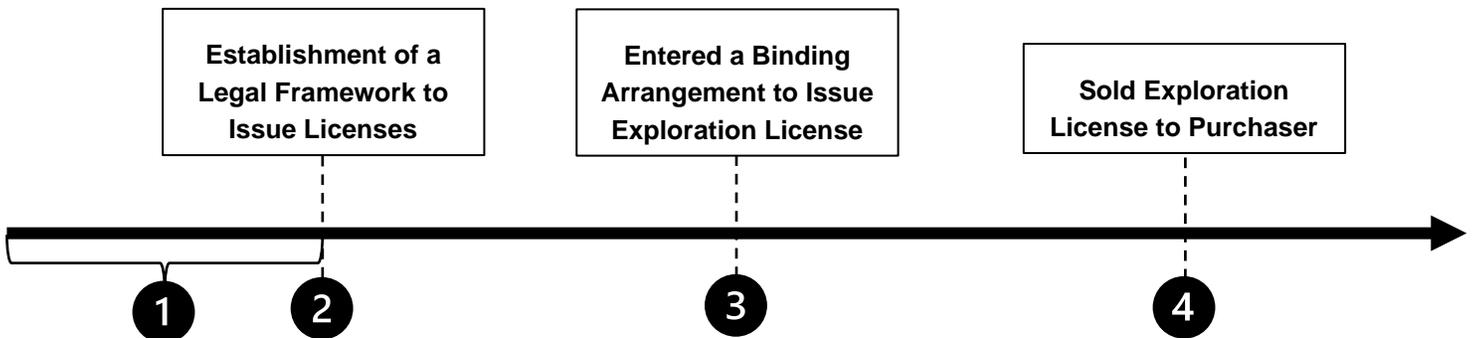
For the purposes of this example, it is assumed that the arrangement to issue exploration licenses embodies a performance obligation which is satisfied upon the issuance of the license—i.e., satisfied at a point in time. Other than the issuance of the exploration license, there are no other performance obligations in the arrangement.

The following timeline illustrates the typical events leading up to the sale of exploration licenses and provides commentary regarding the recognition of an asset at each step in the timeline. As discussed in the IPSASB paper, the principles in the Conceptual Framework would prevent recognition of an asset for the sovereign power on its own.

However, as illustrated below, once the entity has exercised its sovereign power by setting up a framework to issue licenses, the actual sale of licenses will result in the recognition of an asset.

² It should be noted that the IPSASB also instructed the staff to include an analysis of measurement considerations, but this analysis is not included in the scope of this paper.

Timeline



- (1) Prior to an establishment of the legal framework, there is no legal mechanism for the government entity to issue exploration licenses—i.e., it would not be possible for an exploration license to exist within the laws of the jurisdiction. Therefore, during this period, it would not be possible to recognize any asset.
- (2) Upon establishment of a legal framework to issue licenses, it will be possible for an exploration license to legally exist within the jurisdiction. At this stage in the timeline, the government entity may start negotiating with other entities to sell exploration licenses. However, at this point, as no past event has occurred, there continues to be no asset to be recognized. Furthermore, the government entity will have no information on how to measure any asset, such as how many, if any, licenses will be sold, when licenses would be sold, how much licenses will be sold for, or whether licenses will be sold for a fixed or variable amount. As a result, even upon the establishment of a legal framework to issue licenses, as no past event has occurred and no information exists to measure any potential asset, the government entity would not be able to recognize any asset.
- (3) At this point, a government's sovereign power in itself still cannot be recognized as an asset. However, the exercise of the sovereign power through the establishment of the legal framework has made it possible for the government to sell licenses. Once the government has entered into a binding arrangement to sell a license to a purchaser, the government entity can recognize a binding arrangement asset and a corresponding binding arrangement liability at the agreed upon transaction price.³ It should be clarified that this binding arrangement asset represents the government's right to consideration, conditional on its sale of the license, and does **not** embody the sovereign right.

Furthermore, **until the government entity actually issues the license, or the purchaser has paid consideration, the government entity would not present the binding**

³ The above accounting is based on the IPSASB's proposals in ED 70, *Revenue with Performance Obligations*. Under IPSAS 9, *Revenue from Exchange Transactions*, the sale of the license in the example would be assessed against IPSAS 9's recognition criteria, which include consideration of: the transfer of risks and rewards; continuing managerial involvement; ability to reliably measure revenue; the probability of economic benefits or services potential flowing to the government; and the ability to reliably measure the costs incurred or to be incurred. If the recognition criteria are met, revenue and an account receivable would be recognized at the fair value of consideration.

arrangement asset and binding arrangement liability on a gross basis, as neither party has performed. Effectively, until either party has performed, the binding arrangement asset and liability would net to zero in the financial statements. See paragraph 104 of [draft] IPSAS [X] (ED 70), *Revenue with Performance Obligations*, which requires presentation of a binding arrangement in the statement of financial position only once either party has performed, and also paragraph IE223, which further explains this requirement.

- (4) Upon the issuance of a license, the government entity has satisfied its performance obligation and established an unconditional right to receive consideration. As a result, the government entity would reclassify the binding arrangement asset to an account receivable at the transaction price at this point in the timeline. At this point, the binding arrangement liability would also be recognized as revenue.

While the issuance of the license and subsequent recognition of an account receivable were made possible by the exercise of the sovereign power, it should be noted that the account receivable itself does **not** embody the sovereign power. Rather, the account receivable is the unconditional right to receive the license fee.

9. The above example and timeline illustrates that until a government exercises its sovereign power by establishing a legal framework and enters into a binding arrangement with a counterparty to issue a license, the service potential or economic benefits which could potentially flow from its sovereign power cannot be recognized as an asset.

CAG Question:

Do CAG members have any other considerations which should be added to the above example and timeline to help constituents better understand the IPSASB's conclusion that a government's sovereign power, in and of itself, cannot be recognized as an asset?

Do CAG members share the concern, as noted in paragraph 6, that governments may be incentivized to sell off natural resources and related licenses as a result of the COVID-19 pandemic? If so, please provide your views and advice on how the IPSASB might address this issue in the Natural Resource Consultation Paper.

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

Project: Natural Resources

#	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.	Yes	The IPSASB considered the project brief at its March 2020 meeting (see Agenda Item 10).
A2.	The IPSASB has approved the project in a public meeting.	Yes	See the minutes of the March 2020 IPSASB meeting (section 10) .
A3.	The IPSASB CAG has been consulted on the project brief.	Yes	At the June 2019 meeting, the CAG was consulted on the following topics, which fed into the development of the project brief: <ul style="list-style-type: none"> • Potential scope of the project • Potential approaches to incorporate IFRS 6 into IPSAS • Proposed project communication plan (See the Agenda Item 6).
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.	Yes	In the project brief that was approved at the March 2020 IPSASB meeting, the IPSASB agreed that a CP should be developed as part of this project. (See Agenda Item 10).
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.		

#	Due Process Requirement	Yes/No	Comments
<i>D. Consideration of Respondents' Comments on an Exposure Draft</i>			
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.		

Appendix B: Links to Other Documents

1. This appendix provides links to document which may be useful to CAG members in providing a background related to the project.
 - (a) [Natural Resources project page](#)
 - (b) [Natural Resources: Project Brief and Outline](#)
 - (c) [Agenda Item 10.2.1: Recognition of the Sovereign Power to Issue Exploration Licenses as an Asset](#)