CONCEPTUAL FRAMEWORK: ELEMENTS AND RECOGNITION IN FINANCIAL STATEMENTS

Objective(s) of Agenda Item

1. The objectives of the session are:

   (a) To consider the Issues Paper on the further drafts of Chapter 5, *Elements in Financial Statements*, and Chapter 6, *Recognition in Financial Statements*, and provide directions on those issues;

   (b) To review further drafts of the final chapters and provide directions for further development and finalization of these Chapters.

Material(s) Presented

- Agenda Item 4B.2A: Marked-Up Draft of Chapter 5
- Agenda Item 4B.2B: Clean Draft of Chapter 5
- Agenda Item 4B.3A: Marked-Up Draft of Chapter 6
- Agenda Item 4B.3B: Clean Draft of Chapter 6
- Agenda Item 4B.4: Draft Minutes March 2014 Meeting
CONCEPTUAL FRAMEWORK: ISSUES PAPER ON FURTHER DRAFT OF CHAPTER 5, ELEMENTS IN FINANCIAL STATEMENTS AND CHAPTER 6, RECOGNITION IN FINANCIAL STATEMENTS

Objectives of Issues Paper
1. This aim of this Issues Paper is to highlight key issues in the further drafts of Chapter 5, Elements in Financial Statements, and Chapter 6, Recognition in Financial Statements, on which staff seek directions so that the draft chapter can be finalized.

Structure of Issues Paper and Key Issues Addressed
2. The Issues Paper includes a brief background section. The paper then addresses four issues on which staff seeks directions. Following discussion of these issues Staff proposes that the IPSASB carries out a page-by-page review of the marked-up draft final chapters at Agenda Item 4C.2A and 4C.3A. Clean versions of the draft final chapters are provided at Agenda Items 4C.2B and 4C.2C. These clean versions provide a better perspective on the overall flow of the chapters.

Background
3. Conceptual Framework Exposure Draft (CF–ED2), Elements and Recognition in Financial Statements, was issued in early November 2012 with a consultation period that expired on April 30th 2013. Forty responses were received. These responses are available on the IPSASB website. The issues raised by respondents were discussed at the June and September 2013 meetings. The most significant issue was the approach to deferred flows. CF–ED2 proposed definitions of deferred inflows (DIs) and deferred outflows (DOs) as elements. These proposed elements were restricted to non-exchange transactions that contained specific time stipulations. Most respondents to CF–ED2 did not support these elements. However, a significant number of respondents expressed the view that information on flows relating to particular reporting periods has information value.

4. At the December 2013 meeting the IPSASB reviewed five options for addressing deferred flows and decided to adopt an approach in which the Framework would not define DIs and DOs as elements, but would acknowledge that other items might need to be recognized in the financial statements in order to meet the objectives of financial reporting. The Framework uses the overarching term “other economic phenomena” in section 1 to describe these items. In subsequent sections of the chapter “other economic phenomena” are described as “other resources” and “other obligations”

5. The IPSASB carried out a review of a draft final chapter incorporating material on other economic phenomena at the March 2014 meeting and considered a number of other drafting changes and clarifications proposed by staff. As a result of this review the IPSASB directed staff to restructure the chapter, remove certain material from the core text of the Framework and make the drafting more concise. The IPSASB directed that some of the material deleted in the core text should be included in the Basis for Conclusions. The IPSASB also directed that the sub-section on recognition should be relocated to a new and separate chapter. The draft minutes of the March meeting are attached at Agenda Item 4B.4.
6. The most significant changes from the March 2014 version(s) and the reasons for change are summarized in staff comment boxes throughout the revised versions at Agenda Items 4B.2A and 4B.3A (and 4B.2B and 4B.3B). These include reflections of the decisions:

   • To focus on net financial position rather than net assets as the residual amount (rather than providing two measures of residual amount), but not to provide an interpretation of net financial position; and
   • Not to include an interpretation of financial performance in the sub-section on revenue and expense, but to include a summary of the IPSASB’s deliberations on financial performance in the Basis for Conclusions and the reasons for not interpreting financial performance in the Framework.

7. Before commencing a page-by-page review of the final chapter there are four issues for discussion. Following the page-by-page review Staff highlight the issue of re-exposure, although, in accordance with due process, detailed discussion of, and decisions on re-exposure, will be carried out after the approval of Chapter 5.

**Key Issues Addressed in this Paper**

8. This section of the paper addresses:

   • Restructuring of Chapter 5 and relocation of material on recognition into Chapter 6
   • Definitions of revenue and expense
   • Incorporation of background material on approach to deferred flows and adoption of approach to other economic phenomena in Basis for Conclusions
   • Discussion of financial performance in Basis for Conclusions

Restructuring of Chapter 5 and relocation of material on recognition into Chapter 6,

9. In accordance with the direction at the March meeting the sub-section on recognition has been relocated to a separate chapter and Chapter 5 has been restructured as follows;

   • Introduction
   • Assets
   • Liabilities
   • Other Resources and Other Obligations and Net Financial Position
   • Revenue and Expense
   • Ownership Contributions and Ownership Distributions

10. The positioning of the sub-section on revenue and expense after the section on other resources, other obligations and net financial position reflects the fact that the definitions of revenue and expense refer to other resources and other obligations. As indicated above the subsection on recognition has been relocated to a separate Chapter 6.
Matter(s) for Consideration

1. Does the IPSASB consider that the revised structure of Chapter 5 and the relocation of the sub-section on recognition to Chapter 6 are appropriate? If not, what further restructuring is necessary?

Definitions of Revenue and Expense

11. At the March 2014 meeting the IPSASB decided to define revenue and expense by reference to movements in net financial position rather than movements in net assets. The IPSASB considered the draft definitions of revenue and expense over complex and directed that they should be simplified to focus on net financial position, while describing inflows and outflows in supporting narrative. Staff was directed to develop revised definitions. The revised simplified versions are in section 5:

Revenue is:
(a) Increases in net financial position of an entity, other than ownership contributions; and
(b) Reductions in amounts recognized as other obligations in previous reporting periods.

Expense is:
(c) Decreases in the net financial position of an entity, other than ownership distributions; and
(d) Reductions in amounts recognized as other resources in previous periods.

12. Staff has reservations that these definitions are too concise and do not sufficiently capture the importance of inflows of resources for revenue and outflows of resources for expense. They seem to be more of a description of how components of surplus or deficit for the reporting period are derived. Although more cumbersome, Staff would prefer the following definitions, which are less concise but more informative:

Revenue is:
(a) Inflows of resources that increase the net financial position of an entity, other than ownership contributions; and
(b) Reductions in liabilities and amounts recognized as other obligations in previous reporting periods.

Expense is:
(c) Outflows of resources that decrease the net financial position of an entity, other than ownership distributions; and
(d) Reductions in assets and amounts recognized as other resources in previous periods.

Matter(s) for Consideration

2. Does the IPSASB support the revised versions of revenue and expense in paragraph 12 proposed by staff? If not, which what amendments should be made to these definitions?
Incorporation of background material on approach to deferred flows and adoption of approach to other economic phenomena in Basis for Conclusions

13. The Issues paper for the March 2014 meeting included fairly detailed background material on the IPSASB’s discussion of contrasting models of financial performance and the development of proposals on deferred flows, culminating in the decisions to acknowledge that other economic phenomena might need to be recognized in the financial statements in order to meet the objectives of financial reporting. The IPSASB considered that this was a better explanation of the evolution of the IPSASB’s deliberations, views and decisions on financial performance, deferred flows and other economic phenomena than the material in the Basis for Conclusions in the March version. The IPSASB therefore directed staff to incorporate this material in the Basis for Conclusions with appropriate modifications.

14. Staff has therefore significantly expanded the sub-section of the Basis for Conclusions entitled *Elements and Financial Performance*. This material is in paragraphs BC2-BC15. The sub-section of the Basis for Conclusions on other resources and other obligations and net financial position cross-refers to this material in paragraph BC53.

**Matter(s) for Consideration**

3. Does the IPSASB support the inclusion of the more detailed material on the evolution of the IPSASB’s deliberations, views and decisions on financial performance, deferred flows and other economic phenomena? If not, how should this material be modified?

Discussion of financial performance in Basis for Conclusions

15. Paragraphs 4.8 and 4.9 of the March 2014 version of the draft final chapter discussed financial performance (interpretation of surplus and deficit) in the context of operating and funding models in the public sector, the equivalent of the business model in the profit-oriented sector. As indicated in the minutes members expressed reservations about the inclusion of this material because (i) the relevance of the business model approach in the public sector has been only recently explored and (ii) these paragraphs had not been exposed in CF–ED2. Nevertheless members welcomed the insights in this material and directed that a summary should be included in the Basis for Conclusions together with the reason why it was not included in the core text. In accordance with this direction the material has been summarized in paragraphs BC64 and BC65.

**Matter(s) for Consideration**

4. Does the IPSASB consider that the summary of the discussion on financial performance in paragraphs BC64 and BC65 is appropriate? If not, how should it be amended?

Re-exposure of Chapter 5

16. As indicated above, the IPSASB decided not to include definitions of DIs and DOs as proposed in CF–ED2, but to acknowledge that “other economic phenomena” might need to be recognized in order to meet the objectives of financial reporting. The current position is a change from the proposal to define DIs and DOs as elements in CF–ED2 and as such warrants discussion as to whether re-exposure is necessary. Under the current due process such consideration will take place after the chapter has been approved. Staff will provide an evaluation of the reasons for and against re-exposure at the September meeting.
Matter(s) for Consideration

5. The IPSASB is asked to note that Staff will provide an evaluation of the reasons for and against re-exposure at the September meeting.
**CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES: ELEMENTS AND RECOGNITION IN FINANCIAL STATEMENTS**

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1. Introduction

Staff Comment: Reference to recognition in paragraph 1.1 has been deleted, because Recognition is now addressed in Chapter 6.

**Purpose of this Chapter**

1.1 This Chapter defines the elements used in general purpose financial statements (financial statements) of governments and other public sector entities (public sector entities) and provides further explanation about those definitions. It also deals with recognition.

**Elements and their Importance**

1.2 Financial statements portray the financial effects of transactions and other events by grouping them into broad classes which share common economic characteristics. These broad classes are termed the elements of financial statements. Elements are the building blocks from which financial statements are constructed. These building blocks provide an initial point for recording, classifying and aggregating economic data and activity in a way that provides users with information that meets the objectives of financial reporting\(^1\) and contributes to the qualitative characteristics (QCs) of financial reporting.\(^2\) The elements in the statement of financial position are assets and liabilities. The elements in the statement of financial performance are revenue and expenses. Ownership contributions and ownership distributions are elements of other financial statements included in GPFRs. Determining which definition an item meets will, subject to the satisfaction of recognition criteria, also determine the financial statement in which the item is displayed.

1.3 The elements defined in this Chapter are not the individual items themselves. Sub-classifications of individual items within an element and aggregations of combinations of items are used to enhance the understandability of the financial statements. Presentation is addressed in Chapter 7 *Presentation in General Purpose Financial Reports* of this Conceptual Framework.

1.4 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 of an entity, recognition of economic phenomena that are not captured by the elements as defined in this Chapter may be necessary. Consequently, the identification of the elements in this Chapter does not preclude IPSASs from requiring or allowing the recognition of resources or obligations that do not satisfy the definition of an element identified in this Chapter (hereafter referred to as “other resources” or “other obligations”) when necessary to better achieve the objectives of financial reporting.

**Elements Defined and Approach to Recognition**

Staff Comment: Previous paragraph 1.6 has been deleted in accordance with the direction at the March meeting and references to ‘net assets’ in previous paragraph 1.8 have been deleted. The formula for ‘net financial position’ has been retained, but the narrative description that included a reference to ‘net assets’ has been deleted.

\(^1\) The objectives of financial reporting, as stated in Phase 1 of the Framework, are to provide information about the entity useful to users for accountability and decision making purposes. *(Staff Comment: This is a staff amendment to better align with the explanation of the objectives in Chapter 2.)*

\(^2\) The QCs are relevance, faithful representation, comparability, verifiability, timeliness and understandability.
1.5 The elements that are defined in this Chapter are:

(a) Assets;
(b) Liabilities;
(c) Revenue;
(d) Expenses;
(e) Ownership contributions; and
(f) Ownership distributions.

1.6 Net assets is the aggregate of an entity’s assets less liabilities at the reporting date and can be represented by:

\[ \text{Assets} - \text{Liabilities} = \text{Net Assets} \]

1.7 Net financial position is the net assets of an entity and the net amount of other resources less other obligations recognized in the statement of financial position at the reporting date. It can be represented by:

\[ \text{Assets} - \text{Liabilities} + (\text{Other resources} - \text{Other Obligations}) = \text{Net Financial Position} \]

1.8 While net assets and net financial position are defined, neither are but it is not an elements. Section 46 discusses net assets and net financial position in more detail.
2. **Assets**

**Definition**

2.1 An asset is a resource that an entity presently controls as a result of a past event.

**A Resource**

**Staff Comment**: The reference to ‘an asset’ in paragraph 2.3 has been modified to ‘a resource’ in accordance with the direction at the March 2014 meeting. The reference to “holding cash” in paragraph 2.5 (c) has been deleted because it does not relate to an inflow. Staff does not think that this sub-paragraph needs to be relocated.

Other changes to this section are largely editorial.

2.2 A resource is an item with the ability to provide service potential or economic benefits. Physical form is not a necessary condition of a resource. The service potential or economic benefits can arise directly from the resource itself or from the rights to use the resource. Some resources embody an entity’s rights to a variety of benefits including, for example, the right to:

(a) Use the resource to provide services;
(b) Use an external party’s resources to provide services, for example, leases;
(c) Convert the resource into cash through its disposal;
(d) Benefit from the resource’s appreciation in value; or
(e) Receive a stream of cash flows.

2.3 Service potential is the capacity of an asset to be used by the entity to provide services that contribute to achieving the entity’s objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows.

2.4 Public sector assets that embody service potential may include recreational, heritage, community, defense and other assets which are held by governments and other public sector entities and provide services to third parties. Such services may be for collective or individual consumption. Many services may be provided in areas where there is no market competition or limited market competition. The use and disposal of such assets may be restricted. As highlighted in the *Preface to the Conceptual Framework*, many assets that embody service potential are specialized in nature.

2.5 Economic benefits take the form of cash inflows or a reduction in cash outflows. Cash inflows (or reduced cash outflows) may be derived from for example:

(a) An asset’s use in the production and sale of services; or
(b) The direct exchange of an asset for cash or other resources; or
(c) Holding cash itself because of its capacity to acquire other resources.

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3 References to “services” in this Conceptual Framework encompass “goods and services”.

4 *The Preface to the Conceptual Framework* was made available as a staff draft in July 2013.
In addition, an asset may be used to settle a liability or to make an ownership distribution.

An Entity Controls

Staff Comments: The last sentence of paragraph 2.7 has been deleted in accordance with directions at the March 2014 meeting.

While the IPSASB confirmed the decision not to define a past event at the March 2014 meeting it directed that the point about identifying the past event should be made more prominent. The sequence of the sentences in paragraph 2.8 has therefore been amended.

2.6 An entity must have control of the resource. Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.

2.7 In assessing whether it controls a resource, an entity assesses whether the following indicators of control exist:

(a) Legal ownership;
(b) Access to or, conversely, the ability to deny or restrict access to the resource;
(c) The means to ensure that the resource is used to achieve its objectives; and
(d) The existence of an enforceable right to service potential or economic benefits arising from a resource.

While these indicators are not conclusive determinants of whether control exists, identification and analysis of them can inform that decision. For example, if an entity cannot deny the access of certain external parties to a resource it is questionable whether the entity has an asset.

Past Event

2.8 The definition of an asset requires that an asset arises from a past transaction or other event. There are a number of potential points at which such events may occur. It is essential to determine the point or event at which such transactions, rights or powers give rise to an asset of the entity. Entities can obtain assets by purchasing them in an exchange transaction or producing them. In such cases, identification of the past transaction or other event is straightforward. Assets may also arise through non-exchange transactions, including by exercising of sovereign powers. The power to tax or to issue licenses, and to access or restrict or deny access to the benefits embodied in intangible resources like the electromagnetic spectrum, are examples of public sector-specific powers and rights, that other non-public sector entities do not have. It is essential to determine the point or event at which such rights or powers give rise to an asset of the entity. There are a number of potential points at which such events may occur. Taking the example of a tax, the following points in the process may be identified: (a) a general ability to tax, (b) establishment of a power through a statute, (c) exercising the power to create a right, or (d) the taxable event which gives rise to an obligation of another party to pay the tax. When the power is exercised and the rights exist to receive service potential or economic benefits, an asset arises.
3. Liabilities

Staff comment: At the March 2014 meeting, the IPSASB directed that the term “other binding obligation” should be changed to “non-legally binding obligation”. In accordance with the direction at the March meeting, the paragraph on “economic coercion” and “political necessity” has been relocated to paragraph 3.6. Other changes are editorials.

Definition

3.1 A liability is a present obligation of an entity for an outflow of resources that results from a past event.

A Present Obligation

3.2 A present obligation is a legal or other binding requirement which an entity has little or no realistic alternative to avoid.

An Outflow of Resources from the Entity

3.3 A liability must involve an outflow of resources from the entity in order to settle it. An obligation that can be settled without an outflow of resources from the entity is not a liability.

Past Event

3.4 The complexity of public sector programs and activities means that there are a number of potential points in the development, implementation and operation of a program at which a present obligation may arise. This is particularly the case for binding requirements that the entity has little or no realistic alternative to avoid but are not legally enforceable (referred to as “other binding obligations” in this Conceptual Framework).

To satisfy the definition of a liability, it is necessary that a present obligation arises as a result of a past event and requires an outflow of resources from the entity. Where an arrangement has a legal form, such as a contract, a past event may be straightforward to identify, such as when a contract is entered into. In other cases, it may be more difficult to identify the past event and identification involves analysis of when an entity has little or no realistic alternative to avoid an outflow of resources from the entity.

Little or No Realistic Alternative to Avoid

Legal and Other-Non-Legally Binding Obligations

3.5 Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations can arise from both exchange and non-exchange transactions. An obligation must be to an external party in order to give rise to a liability. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Identification of the external party to which the obligation is owed is an indication of the existence of an obligation giving rise to a
liability. However, it is not essential to know the identity of the external party before the time of settlement in order for a present obligation and a liability to exist.

3.6 does not include “economic coercion”, or “political necessity” or other circumstances may give rise to situations, where, although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences to the entity of refusing to do so are such that the entity may not have a realistic alternative but to settle an obligation incur such an outflow. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legal binding obligation (see paragraphs 3.11–3.13).

3.7 Many arrangements that give rise to an obligation include settlement dates. The inclusion of a settlement date may provide an indication that an inflow-outflow of resources gives rise to a liability and is not an ownership contribution (see Section 6). However, there are many agreements that do not contain settlement dates. The absence of a settlement date does not preclude an obligation giving rise to a liability.

3.5 Enforceability does not include “economic coercion” or “political necessity” or other circumstances where, although the public sector entity is not under a legal obligation to settle, the economic or political consequences to the entity of refusing to do so are such that the entity may not have a realistic alternative but to settle an obligation. Economic coercion, political necessity or other circumstances may, however, lead to a liability arising from a binding obligation that is not enforceable in law (see paragraphs 3.11–3.13).

Legal Obligations

3.6 A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent. There are jurisdictions where government and public sector entities cannot have legal obligations because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in this Framework. For some types of non-exchange transactions, judgment will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law there can be no doubt that an entity has no realistic alternative to avoid the obligation and that a liability exists.

3.7 Enforceability does not include “economic coercion” or “political necessity” or other circumstances where, although the public sector entity is not under a legal obligation to settle, the economic or political consequences to the entity of refusing to do so are such that the entity may not have a realistic alternative but to settle an obligation. Economic coercion, political necessity or other circumstances may, however, lead to a liability arising from a binding obligation that is not enforceable in law (see paragraphs 3.11–3.13).

3.8 Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date, but will be enforceable with the passage of time without the external party having to meet further conditions— or having to take any further action—prior to settlement. Claims that are

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5 References to obligations enforceable in law encompass legal obligations and binding obligations subject to alternative processes with equivalent effect.
unconditionally enforceable subject to the passage of time therefore are enforceable obligations in the context of the definition of a liability.

3.93.10 Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this Framework and therefore cannot be recognized. The legal position should be assessed at each reporting date to consider if the legal position has changed and to determine whether a liability still exists.

Other Non-Legally Binding Obligations

3.103.11 Liabilities can also arise from other non-legally binding obligations. Other non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Other non-legally binding obligations that gives rise to liabilities have the following attributes:

(a) The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;

(b) As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and

(c) The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

3.113.12 In the public sector, obligations may arise at a number of points. For example, there are a number of early points in implementing a program or service, including:

(a) Making a political promise such as an electoral pledge;

(b) Announcement of a policy;

(c) Introduction (and approval) of the budget (which may be two distinct points); and

(d) The budget becoming effective (in some jurisdictions the budget will not be effective until an appropriation has been effected).

3.123.13 These early stages are unlikely to give rise to obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to obligations that meet the definition of a liability. The point at which an obligation gives rise to a liability critically depends on the nature of the obligation. Indicators that are likely to impact on judgments about whether the obligation is one that other parties can validly conclude that the entity has little or no realistic alternative to avoid an outflow of resources include:

(a) The nature of the past event or events that give rise to the obligation. For example, a promise made in an election is unlikely to give rise to a present obligation because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it has little or no realistic alternative to avoid settling. However, an announcement made in the legislature by a majority government, particularly one with all party support, in relation to an event or circumstance that has occurred, and where the government has committed to introduce and secure passage of the necessary budgetary provision may, or may not, give rise to an other non-legally binding obligation.
(b) The ability of the entity to modify or change the obligation before it crystallizes. For example, the announcement of policy will generally not give rise to an _other non-legally_ binding obligation which cannot be modified before being implemented. Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before those events occur.

(c) There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, there is a presumption that a _present non-legally_ binding obligation exists. However the absence of a budgetary provision _may not_, _of by itself_, be a reason for not recognizing a liability.
4. Other Resources and Other Obligations and Net Financial Position

Staff comment: In accordance with directions at the March 2014 meeting, the sections on other Resources, Other Obligations and Net Financial Position have been combined and brought forward before the section on Revenue and Expense.

Other Resources and Other Obligations

4.1 Chapter 2 of the Conceptual Framework identifies the objectives of financial reporting as the provision of information useful for accountability and decision-making purposes, outlines the information users will need for those purposes and explains the role of financial statements and other GPFRs in providing such information. Chapter 2 notes that for accountability and decision-making purposes, users will need information about such matters as:

(a) The performance of the entity during the reporting period in meeting its service delivery and financial objectives, managing the resources it is responsible for, and complying with relevant budgetary and other authority regulating the raising and use of resources; and

(b) The liquidity and solvency of the entity and the sustainability of the entity’s service delivery and other operations over the long term, and changes therein as a result of the activities of the entity during the reporting period including, for example, changes to its financial and operating capacity.

4.2 In some cases, in developing or revising an IPSAS, the IPSASB may determine that to achieve the objectives of financial reporting a resource or obligation that does not satisfy the definition of an element should be recognized in the financial statements. In these cases, the IPSAS may require or allow these resources or obligations to be recognized as "other resources" or "other obligations", being classes of items additional to the elements.

Net Financial Position

4.3 Net financial position is the difference between assets and liabilities after adding other resources and deducting other obligations recognized in the statement of financial position. As noted in paragraph 1.6, net financial position is not an element.

4.4 All items that meet the definition of assets and liabilities, and satisfy the recognition criteria set out in Chapter 6 are reported on the statement of financial position. Except where an IPSAS requires or allows items that do not satisfy the definition of an asset or liability to be recognized in the statement of financial position as other resources or other obligations, net financial position is the difference between assets and liabilities. Net financial position can be a positive or negative residual amount.
54. Revenue and Expenses

Staff comments:

In the March 2014 draft this section was section 4. It has been relocated after the combined section 4 on other resources, other obligations and net financial position.

At the March 2014 meeting the IPSASB directed that the definitions of revenue and expense should be simplified. The revised definitions respond to that direction.

Paragraphs 4.3 and 4.5 in the March version has been deleted in accordance with directions at that meeting.

Paragraphs 4.8 and 4.9 have been deleted in accordance with directions at that meeting. A discussion of this material has been included in the Basis for Conclusions.

Definitions

4.1 Revenue is:

(a) Increases in assets and other resources and reductions in liabilities during the current reporting period that increase the net financial position of an entity, other than ownership contributions; and

(b) Reductions in amounts recognized as other obligations in previous reporting periods.

4.2 Expenses arise:

(a) Increases in liabilities and other obligations and reductions in assets during the current reporting period that decrease the net financial position of an entity, other than ownership distributions; and

(b) Reductions in amounts recognized as other resources in previous periods.

Increases and Decreases in Net Financial Position

4.3 Revenues and expenses provide users with information about changes in an entity’s resources and obligations during a period from service delivery and other activities, other than those changes that arise as a consequence of contributions from or distributions to owners. Such information informs assessments of the net financial position of the entity and the reasons for changes therein over the reporting period. As noted in paragraph 1.4, this Conceptual Framework acknowledges that all economic phenomena that should be reported in GPFSs consistent with the objectives of financial reporting may not be captured by changes in assets and liabilities as defined. Therefore, revenues and expenses are defined to encompass changes in assets and liabilities and other resources and other obligations that contribute to a change in the net financial position of the entity over the reporting period and are recognized in the statement of financial position consistent with the requirements of IPSASs.

4.4 Revenue and expenses can arise from exchange and non-exchange transactions, other events such as price changes, unrealized increases and decreases in the value of assets and liabilities, and the consumption of assets through depreciation and erosion of service potential and
economic benefits through impairments. They may arise from individual transactions or groups of transactions.

4.5 Chapter 6 Measurement of Assets and Liabilities in Financial Statements of the Conceptual Framework outlines the measurement bases that may be adopted for financial reporting purposes. It explains that IPSASs will include requirements and provide guidance on the bases that may be adopted for the measurement of revenues and expenses arising from particular transactions or other events.

4.6 Section 6 discusses ownership interests and provides definitions of ownership contributions and ownership distributions. Section 5 provides definitions of deferred inflows and deferred outflows.

Surplus or deficit for the Period

Financial Performance

4.7 All items that meet the definition of revenues and expenses and the recognition criteria set out in Section 7 Chapter 6 are reported on the statement of financial performance. The difference between revenue and expenses is the entity’s surplus or deficit for the period.

4.8 Public sector entities typically have an operating and funding model (sometimes called a business model). The net result of those revenues designated to fund operations during the reporting period, and those expenses incurred as part of its operating model, will be represented either as a surplus or deficit. The net result provides information on the financial performance of the operating and funding model. If a surplus, this measure provides an indicator of the ability of the entity to reduce demands on resources from resource providers, increase services provided to recipients, or to increase the financial resilience of the entity by, for example, reducing debt, or any combination thereof. If a deficit, this measure provides an indicator of the need to increase demands on resources from resource providers, reduce services provided to service recipients, or to reduce the financial resilience of the entity by, for example, increasing debt, or any combination thereof.

4.9 This Conceptual Framework does not define “revenues designated to fund operations during the reporting period”, nor “expenses incurred as part of its operating model” as separate elements. IPSAS may however make such classifications of items to respond to the information needs of service recipients and resource providers as identified in Chapter 2 of this Conceptual Framework.
Other Resources and Obligations

5.1 Chapter 2 of the Conceptual Framework identifies the objectives of financial reporting as the provision of information useful for accountability and decision-making purposes, outlines the information users will need for those purposes and explains the role of financial statements and other GPFRs in providing such information. Chapter 2 notes that for accountability and decision-making purposes users will need information about such matters as:

(a) The performance of the entity during the reporting period in meeting its service delivery and financial objectives, managing the resources it is responsible for, and complying with relevant budgetary and other authority-regulating the raising and use of resources; and

(b) The liquidity and solvency of the entity and the sustainability of the entity's service delivery and other operations over the long term, and changes therein as a result of the activities of the entity during the reporting period including, for example, changes to its financial and operating capacity.

5.2 In some cases, in developing or revising an IPSAS, the IPSASB may determine that to achieve the objectives of financial reporting a resource or obligation that does not satisfy the definition of an element should be presented in the financial statements. In these cases, the IPSAS may require or allow these resources or obligations to be recognized as "other resources" or "other obligations", being classes of items additional to the elements.
6. **Net Assets, Net Financial Position, Ownership Contributions, and Ownership Distributions**

Staff Comment: References to “net assets of the entity” have been changed to “net financial position”. The section on Net Financial Position has been relocated to Section 4. Staff has changed the reference to “net assets” in paragraph 6.5 to “resources”.

**Definitions**

**Net Assets and Net Financial Position**

6.1 Net assets is the difference between assets and liabilities. Net financial position is the difference between assets and liabilities after adding other resources and deducting other obligations recognized in the statement of financial position. As noted in paragraph 1.8, neither net assets nor net financial position are elements.

6.2 All items that meet the definition of assets and liabilities, and satisfy the recognition criteria set out in Section 7 of this Chapter are reported on the statement of financial position. Except where an IPSAS requires or allows an item that does not satisfy the definition of an asset or liability to be recognized in the statement of financial position as an other resource or an other obligation, net assets and net financial position will both be determined as the difference between assets and liabilities. Net assets and net financial position can be a positive or negative residual amount. Ownership contributions and ownership distributions are reported in other financial statements included in GPFRs.

**Ownership Contributions and Ownership Distributions**

**Definitions**

6.1 Ownership contributions are inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net assets-financial position of the entity.

6.2 Ownership distributions are outflows of resources from the entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the net assets-financial position of the entity.

6.3 It is important to distinguish inflows of resources from owners, including those inflows that initially establish the ownership interest, and outflows of resources to owners in their capacity as owners, from revenue and expenses. In addition to the injections of resources and dividend payments that may occur, in some jurisdictions it is relatively common for assets and liabilities to be transferred between public sector entities for no consideration. Where such transfers satisfy the definitions of ownership contributions or ownership distributions they will be accounted for as such.

6.4 Ownership interests may arise on the creation of an entity when another entity contributes resources to provide the new entity with the capacity to commence operational activities. In the public sector, contributions to, and distributions from, entities are sometimes linked to the restructuring of government and will take the form of transfers of assets and liabilities rather than cash transactions. Ownership interests may take different forms, which may not be evidenced by an equity instrument.

6.5 Ownership contributions give a right to a return or increased return to owners, and may take the form of an initial injection of resources at the creation of an entity or a subsequent injection
of resources, including injections in the event of the entity being restructured. The return to owners may be either a) a return on investment; b) a return of investment; or, c) in the event of the entity being wound up or restructured, a return of any net assets.
7. **Recognition**

**Staff Comment:** Section 7 on Recognition has been transferred to a separate chapter. See Agenda Items 4B.3A and 4B.3B.
Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

Section 1: Introduction

BC1. Respondents to the Conceptual Framework, Consultation Paper, *Elements and Recognition in Financial Statements* (CF–CP2), which was issued in December 2010, questioned why the IPSASB was only addressing elements for the financial statements in this phase of the Framework. They suggested that IPSASB should also develop elements for economic phenomena in the “more comprehensive” areas of financial reporting outside the financial statements, as outlined in Chapter 1 of the Framework. The IPSASB acknowledged the merits of these views and agrees that there is a need to develop such elements in the future. The IPSASB, however, decided that in order to put its future standard-setting activities for the financial statements on a sound and transparent footing it is important to deal firstly with the development of elements for the financial statements.

Elements and Financial Performance

Staff Comment: Following discussion at the March meeting this section has been replaced by material taken from the Background section of the Issues Paper from the March 2014 meeting.


BC2. CF–CP2 discussed two contrasting approaches to financial performance:

- An approach that measures financial performance as the net result of all changes in the entity's resources and obligations during the period (described as the asset and liability-led approach (A & L-led approach)); and

- An approach that measures financial performance as the result of the revenue inflows and expense outflows more closely associated with the operations of the current period (described as the revenue and expense-led approach (R & L-led approach).

BC3. CF–CP2 noted that the two different approaches could lead to different definitions of the elements related to financial performance and financial position. The R & E-led approach is strongly linked to the notion of inter-period equity. Inter-period equity refers to the extent to which the cost of providing programs and services in the reporting period is borne by current taxpayers and current resource providers. The A & L-led approach is linked to the notion of changes in resources available to provide services in the future and claims on these resources as a result of period activity.

BC4. A further section of CF–CP2 discussed “Other Potential Elements” and pointed out that, if IPSASB adopted the R & L-led approach, IPSASB would need to address deferred flows. Under this approach deferred flows are items that do not meet the proposed definitions of revenue and expense, but which are nevertheless considered to affect the financial performance of the period. CF–CP2 identified three options for dealing with deferred flows:

- Defining deferred inflows (DIs) and deferred outflows (DOs) as elements on the statement of financial position:
• Broadening the asset and liability definitions to include items that are deferrals; or
• Describing deferred flows as sub-classifications of net assets/net liabilities (subsequently referred to as the residual amount)

BC5. CF–CP2 had two specific matters for comment (SMC) on these areas. The first asked constituents to indicate whether they preferred the A & L-led or R & E-led approach and to indicate their reasons. The second asked whether deferrals need to be identified on the statement of financial position. If respondents supported such identification on the statement of financial position they were asked to indicate which of the three approaches in paragraph BC4 they supported.

BC6. The responses to these SMCs were inconclusive. A small majority of respondents expressing a view favored the A & L-led approach. However, a number of respondents who supported the A & L-led approach also indicated that they favored identifying deferrals on the statement of financial position.

Conceptual Framework Exposure Draft, Elements and Recognition in Financial Statements (CF–ED2)

BC7. Following extensive discussions in the second half of 2011 and the first half of 2012 the IPSASB issued CF–ED2 in November 2012. CF–ED2 expressed a view that it is important to be able to distinguish flows that relate to the current reporting period from those that relate to specified future reporting periods. CF–ED2 therefore proposed definitions of a DI and DO as follows:

• A deferred inflow is an inflow of service potential or economic benefits provided to the entity for use in a specified future reporting period that results from a non-exchange transaction and increases net assets; and
• A deferred outflow is an outflow of service potential or economic benefits provided to another entity or party for use in a specified future reporting period that results from a non-exchange transaction and decreases net assets.

BC8. The two key features of these definitions were:

i. The proposed elements were restricted to non-exchange transactions; and

ii. The flows had to be related to a specified future period.

BC9. The IPSASB’s rationale for including these characteristics were as risk-avoidance measures to (i) reduce the possibility of DIs and DOs being used widely as smoothing devices and (ii) to ensure that DIs and DOs are not presented on the statement of financial position indefinitely. Two Alternative Views (AVs) contested the approach to DIs and DOs.

BC10. A SMC in CF–ED2 asked constituents whether they agreed with the decision to define DIs and DOs as elements. Respondents who supported the decision to define DIs and DOs were further asked whether they specifically supported the restriction to non-exchange transactions and more broadly whether they supported the proposed definition.

BC11. Most of the respondents to CF–ED2 disagreed with defining DIs and DOs as elements. Many respondents opposed to these elements, expressed reservations about the implications for convergence/alignment with the International Accounting Standards Board’s Conceptual Framework, and International Financial Reporting Standards more generally. A number of
respondents considered that the proposed approach did not reflect economic reality and that it would be more difficult to determine an objective basis for deferring revenue and expenses under the R&L-led model. Nevertheless, a number of respondents also expressed the view that information on flows relating to particular reporting periods has information value.

BC12. The rationale for restricting the definitions to non-exchange transactions was challenged as conceptually weak both by respondents who favored defining DIs and DOs as elements and those opposed to these proposed elements. Respondents also challenged the restriction to specified time periods because it would potentially lead to the different accounting treatment of very similar transactions dependent upon whether a specific period was identified; i.e., a grant without conditions receivable by an entity to finance its general activities for a five year period would have met the definition of a DI, whereas a similar grant for a future unspecified period would have met the definition of revenue.

Finalizing the Elements Chapter

BC13. The IPSASB had to decide how to proceed in drafting the chapter on elements. The IPSASB needed to balance the limited support for the proposals on deferred flows in CF–ED2, with a view that it needed to respond to the perceived needs of users for information about flows relating to particular reporting periods.

BC14. The IPSASB therefore considered five options for the approach to be adopted in the Elements chapter:

A. Defining DIs and DOs as elements in a more principles-based manner and not specifying the financial statements in which the elements are to be recognized. As such, the Chapter would not predetermine the presentation of the elements;

B. Deriving the definitions of revenues and expenses from the asset and liability definitions;

C. Broadening the asset and liability definitions;

D. Accepting that certain economic phenomena that do not meet the definition of any element may need to be recognized in financial statements in order to meet the objectives of financial reporting; and

E. Reporting inflows and outflows that provide service potential or economic benefits, but do not affect assets and liabilities as defined in the Framework and reporting inflows and outflows that do not affect revenue and expenses.

BC15. CF–ED2 proposed that the elements of financial statements be identified as Assets, Liabilities, Revenue, Expenses, Deferred Inflows, Deferred Outflows, Ownership Contributions and Ownership Distributions. CF–ED2 explained that as a result of the nature of activities undertaken in the public sector, a focus on the activities of the current reporting period of a public sector entity is important in providing information for the users of financial statements and thereby in achieving
the objectives of financial reporting. In order to distinguish between those transactions that relate to the reporting period and those that relate to a specified future period, CF–ED2 proposed that non-exchange transactions that give rise to inflows and outflows of resources that are specified for use in a different reporting period should be shown as separate elements, described as deferred inflows and deferred outflows. The IPSASB concluded that it should adopt Option D. It considers that this option acknowledges that there may be circumstances under which the elements may not provide all information in the financial statements for meeting the needs of users and that it is transparent to accept that other items may be recognized. This approach does not involve defining new elements, unlike Option A, and does not involve significant modification of existing definitions of an asset and a liability, unlike Option C. The overarching term “other economic phenomena” been used in section 1 of this chapter to describe such items and the more detailed terms “other obligations” and “other resources” have been used in subsequent sections. The circumstances under which “other obligations and “other resources” will be recognized will be determined at standards-level and explained in the Bases for Conclusions of specific standards.

BC3. A majority of respondents to CF–ED2 did not support the identification of deferred inflows and outflows as elements. However, many of those respondents acknowledged the issue that the IPSASB was attempting to respond to by identifying deferred inflows and deferred outflows as elements. They encouraged the IPSASB to consider other approaches to dealing with the issue. The IPSASB has responded to the views of respondents. This Chapter does not identify deferred inflows and deferred outflows as elements of the financial statements. Rather, it acknowledges that in some circumstances the elements as defined in this Chapter may not capture all the resources and obligations that should be presented in the financial statements of an entity consistent with the objectives of financial reporting. It provides that in these circumstances, IPSASs may require or allow recognition of resources or obligations that do not satisfy the definition of an element (referred to as “other resources” or “other obligations”).

Financial Statements

BC4. This Conceptual Framework identifies the elements of the statement of financial position and statement of financial performance. The IPSASB considered whether this Chapter of the Conceptual Framework should focus on only the definition and explanation of the elements without specifying the financial statements in which those elements are to be recognised. The IPSASB noted that such an approach would allow for the ongoing development of the financial statements that might present information about financial performance and financial position. However, the IPSASB concluded that while such an approach had merit, the statement of financial position and statement of financial performance were, or were often perceived to be, the primary vehicles for communicating information about financial position and performance to users of GPFRs, and the Conceptual Framework should provide clear direction on the elements that were to be recognised in them.

Section 2: Assets

A Resource

BC5. In the public sector, an asset is a resource with the ability to provide service potential or economic benefits. The inflow of resources to an entity contributes to the operating capacity of the entity and therefore its ability to provide services in the future. This Conceptual Framework
confirms that physical form is not a necessary condition of an asset. Many assets, such as buildings, equipment and inventories are tangible, while others, such as current rights are intangible. Financial assets, such as bonds and derivatives are a further category of assets that do not have physical form.

**Unconditional Rights and Executory Contracts**

<table>
<thead>
<tr>
<th><strong>Staff Comment:</strong> Following a direction at the March meeting Staff has inserted a paragraph on the reason why the Basis for Conclusions includes discussion of unconditional rights and executory contracts, noting that these areas are not considered in the core text.</th>
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**Unconditional Rights** and **Executory Contracts**

**BC19.** CF–ED2 discussed unconditional rights and executory contracts. The IPSASB considered whether the Framework should specifically address unconditional rights and executory contacts.

**BC20.** Unconditional rights typically result from contracts or other binding arrangements that require provision of resources to the entity in the future. The IPSASB noted that there can be a large number of such rights and concluded that unconditional rights that represent service potential or economic benefits that are controlled by the entity as a result of a past event give rise to assets. Whether such assets qualify for recognition will be dependent on whether recognition criteria have been satisfied. The IPSASB concluded that the Framework should not specifically address unconditional rights.

**Executory Contracts**

**BC21.** Executory contracts are binding arrangements, where there is an unconditional promise to receive resources and an equal promise to transfer resources to the counterparty in the future. Public sector entities are likely to engage in a large number of such arrangements. The IPSASB acknowledged the view that such arrangements may give rise to both assets and liabilities, as the promise to receive benefits is likely to have value and the promise to transfer benefits involves a present obligation to sacrifice resources, which the entity has no realistic alternative to avoid. The IPSASB also acknowledged the view that recognizing assets and liabilities from executory contracts would involve the inclusion of potentially very large offsetting amounts in the statement of financial position and the statement of financial performance and that this may conflict with the QC of understandability. Whether assets and liabilities arise from rights and obligations in executory contracts will be determined by an assessment of whether those rights and obligations satisfy the definitions and recognition criteria identified in this Conceptual Framework. Such assessments and mechanisms for presentation in financial statements of any elements arising from executory contracts that best satisfy the QCs will be considered at standards level. The IPSASB therefore decided not to address executory contracts specifically in the Framework.
Service Potential and Economic Benefits

BC9. BC22. The term "service potential" has been used to identify the capacity of an asset to provide services in accordance with an entity’s objectives. The term “economic benefits” has been used to reflect the ability of an asset to generate net cash inflows. Some argue that economic benefits includes service potential, others argue that service potential includes economic benefits, and still others consider that the terms can be used interchangeably. The IPSASB considered whether in the context of the substance of an asset, the explanation of a resource should include a reference to both service potential and economic benefits, and decided that it should. In making this decision, the IPSASB acknowledged the view that economic benefits includes service potential and also considered the converse view that because the primary objective of public sector entities is the delivery of services, generally in non-exchange transactions, service potential should be separately identified. The IPSASB noted that many respondents to CF–CP2 and CF-ED2 supported inclusion of a specific reference to service potential.

BC10. BC23. The IPSASB therefore concluded that because the primary objective of most public sector entities is to deliver services, but also in acknowledgment of the fact that public sector entities may carry out activities with the sole objective of generating net cash inflows, the explanation of a resource should include both the terms service potential and economic benefits.

An Entity Controls

BC11. BC24. The IPSASB considered whether “control” is an essential characteristic of an asset or whether other indicators such as the following should be identified as essential characteristics of an asset: (a) legal ownership, (b) the right to access, and to restrict or deny the access of external parties to, the resource, (c) the means to ensure that the resources are used to achieve its objectives, and (d) the existence of enforceable rights to service potential or economic benefits arising from a resource. The IPSASB acknowledged the views of those who argue that control may be difficult to apply in some cases because it requires judgment to assess whether control exists. In addition, control can be erroneously applied to a resource in its entirety and not to the individual benefits that accrue from the resource. However, notwithstanding such difficulties, the IPSASB concluded that control is an essential characteristic of an asset because the presence of control facilitates the association of an asset with a specific entity, particularly in the public sector environment.

BC12. BC25. Legal ownership of the underlying resource, such as a property or item of equipment, is one method of accessing the benefits provided by an asset. However, rights to benefits may exist without legal ownership of the underlying resource. For example, the rights to the benefits through the holding and use of leased property are accessed without legal ownership of the leased asset itself. Therefore, legal ownership is not an essential characteristic of an asset. Legal ownership is, however, an indicator of control.

BC13. BC26. The right to access a resource may give an entity the ability to determine whether to (a) directly use the resource’s service potential to provide services to beneficiaries, (b) exchange the benefits for another asset, such as cash, or (c) use the asset in any of the other ways that may provide benefits. While it might be questioned whether a resource that cannot be used to meet an entity’s objectives gives rise to an asset, such a resource could be exchanged for an alternative and more appropriate resource.
BC14. While access to a resource is crucial, there are resources to which an entity has access which do not give rise to assets, such as air. Therefore, the ability to access a resource must be supplemented by the ability to deny or restrict the access of others to that resource. For example, (a) an entity might decide whether to set an entrance fee to a museum, and (b) government may control a natural resource under its land to which it can restrict the access of others. Legally enforceable claims to specific benefits such as right of road access or to explore land for mineral deposits could represent an asset to the holder. However an entity may be able to access the service potential or economic benefits associated with a resource in ways other than legal rights. For example, an entity may be able to ensure continuing access to specific rights by imposing effective economic or social sanctions on other parties.

BC15. The IPSASB took the view that the factors identified in paragraph BC2411 are likely to be persuasive indicators of the existence of control rather than essential characteristics. For example, the inability of an entity to restrict or deny access of some external parties to a resource may raise doubts about whether the resource constitutes an asset of the entity.

BC16. The IPSASB also considered whether the economic ownership approach is a viable alternative to the control approach. The economic ownership approach focuses on an entity’s exposure to the underlying economic attributes that contribute to an asset’s value to the entity. Some respondents to CF–CP2, in supporting the control approach, commented on the complexity of the economic ownership approach. The IPSASB concluded that the economic ownership approach is subjective and difficult to operate and therefore rejected this approach.

BC17. The IPSASB then considered whether an analysis of exposure to the risks and rewards of ownership is a useful indicator of control. The IPSASB decided not to include it as an indicator of control. The control approach focuses on the power of the entity to direct how the resource is used so as to benefit from the service potential and/or economic benefits embodied in the resource. The risks and rewards approach focuses on an entity’s exposure to the underlying economic attributes that contribute to an asset’s value to the entity and the related risks. Consideration of the risks and rewards associated with particular transactions and events, and which party to any transaction or event bears the majority of those risks and rewards, may be relevant and useful in identifying the nature of the asset controlled by parties to the transaction or event. However, it is not of itself an indicator of which party has the capacity to direct how the resource is used so as to meet its service delivery objectives. In addition, given the range and nature of commercial and social risks and rewards that are associated with many resources of public sector entities, it is not clear how the various risks and rewards can be weighted and aggregated to provide a useful indicator of which party bears the majority of those risks and rewards.

BC18. Some argue that identification of a past transaction or other event which gives rise to the asset is an essential characteristic of an asset. Others take the view that the identification of a past event is not necessary and should not therefore be an essential characteristic of an asset. They
consider that such a requirement places undue emphasis on identifying the past event that gave rise to an asset. Such emphasis may be a distraction and lead to debates about which event is the triggering event instead of the more important issue of focusing on whether the rights to benefits exist at the reporting date. Those who take this view consider that the essential characteristic of an asset should be the existence of a resource. Some may also accept that a past event might provide useful supporting evidence of the existence of an asset, but not that it should be an essential characteristic.

Many respondents to CF–CP2 and CF-ED2 took the view that a past event should be identified as an essential characteristic of the definition of an asset. The IPSASB agreed with these respondents. In particular, the IPSASB considered that the complex nature of many public sector programs and activities means that there are a number of points at which a resource might arise and therefore identification of the appropriate past event is crucial in identifying whether an asset exists.

As highlighted in the Preface to the Conceptual Framework, the powers and rights of government are particularly significant for the identification of assets. Assets may be created in non-exchange transactions, and by virtue of the exercise of sovereign powers. The power to tax and issue licenses, and other powers to access or to deny or restrict access to the benefits embodied in intangible resources like the electromagnetic spectrum are examples of public-sector specific powers that private sector entities do not have. Given the significant powers that accrue to sovereign governments and, in certain circumstances, other public sector entities, it is often difficult to determine when such powers give rise to a right that is a resource and asset of the entity.

A government’s power to establish a right to levy a tax or fee, for example, often begins a sequence of events that ultimately results in the flow of economic benefits to the government. The IPSASB considered two views of when an asset arises from the powers and rights of government. The first view is that the government has an inherent power to tax at every reporting date and, therefore, that the general ability to levy taxes or fees is an asset. Proponents of this view accept that such an asset is unlikely to be capable of faithfully representative measurement, but argue that this should not deflect from the view that government has a perpetual asset. The countervailing view is that the power to levy taxes and fees must be converted into a right by legal means and that such a right must be exercised or exercisable in order for an asset to come into existence. Many respondents to CF–CP2 and CF-ED2 supported this latter view. The IPSASB agreed with these respondents. In particular, the IPSASB considered that a government’s inherent powers do not give rise to assets until these powers are exercised and the rights exist to receive service potential or economic benefits.

Section 3: Liabilities

A Present Obligation

Staff comment: Staff has added additional wording to paragraph BC35 to refer to the view that the term "non-legally binding obligations" refers to potentially illegal obligations and the rejection of such a view by the IPSASB.

Staff has added paragraph BC36 as a lead-in to the discussion of conditional, unconditional stand-ready obligations and performance obligations.
A sentence has been added to paragraph BC 39 stating that stand-ready obligations are a type of conditional obligation.

**BC22 BC35.** In considering when obligations are present obligations, the IPSASB accepted that a legal obligation gives rise to a present obligation. What is a present obligation may vary between jurisdictions but there is usually general agreement that those obligations that are recognized in law in a jurisdiction give rise to a present obligation. In some jurisdictions, public sector entities are not permitted to enter into certain legal arrangements, but there are equivalent mechanisms. Such mechanisms are considered legally binding. The IPSASB then considered how to classify obligations that were not legal obligations. The IPSASB noted that “constructive obligations” is a term embedded in standard setting literature globally and has been used in IPSASs. However, it has proved difficult to interpret and apply in a public sector context. Therefore, the IPSASB considered alternative terminology, for example the term “a social or moral duty or requirement.” The IPSASB was concerned that the term “social” might be confused with political values and that the term “moral obligations” risks a perception that standard setters and preparers are arbiters of morality. The IPSASB therefore decided that making a distinction between legal and “other non-legally binding obligations” was the most straightforward and understandable approach. The IPSASB considered and rejected the view that the term “non-legally binding obligations” refers to obligations, the legality of which is questionable. Paragraph BC33 discusses other non-legally-binding obligations.

**BC36.** In the context of a present obligation the IPSASB considered conditional and unconditional obligations, stand-ready obligations and performance obligations

*Conditional and Unconditional Obligations*

**BC17. BC23-BC37** An unconditional obligation is one that stands on its own, independent of future events. A conditional obligation relies on the possible occurrence of a future event which may or may not be under the control of the reporting entity. The IPSASB concluded that it is possible for conditional obligations to give rise to liabilities as defined in this Conceptual Framework. Determining whether a conditional obligation satisfies the definition of a liability will involve consideration of the nature of the obligation and the circumstances in which it has arisen. Given the complexity of public sector programs and activities, whether the past event (or events) which has resulted in the entity having no realistic alternative to avoid an outflow of service potential or economic benefits has occurred may not always be clear. Guidance on whether conditional obligations that exist in particular arrangements or circumstances may give rise to liabilities consistent with the definitions identified in this Conceptual Framework is a standards-level issue.

**BC38.**

**BC18. BC24 BC38.** A variety of terms are used to describe present obligations that may arise from, or exist in conjunction with, conditional obligations in particular circumstances. Amongst these are “stand ready-obligations” and “performance obligations”. The characteristics of these obligations are outlined below.
Stand-Ready Obligations

BC19. Stand-ready obligations are obligations that a type of conditional obligation. Stand-ready obligations require an entity to be prepared to fulfill an obligation if a specified uncertain future event outside the entity’s control occurs (or fails to occur). The liability is the unconditional obligation to provide a service which results in an outflow of economic benefits. The term stand-ready obligation is used to describe a liability that may arise in certain contractual circumstances, such as those related to insurance, certain financial instruments such as a derivative contract in a loss position, and for warranties where the entity has an unconditional obligation to stand ready to transfer the resources if the specified future event occurs (or does not occur). In such circumstances, there may be an identifiable past event and an outflow of resources from the entity, although the exact identity of the party to whom settlement will be made will not generally be known. CF–CP2 included a discussion of stand-ready obligations. Many respondents indicated that the distinction between a conditional obligation and a stand-ready obligation is ambiguous.

BC20. CF–ED2 explained that the term stand-ready obligation is not widely used, and does not work well, in the public sector and suggested that. Consequently, whether a stand-ready obligation gave rise to a liability is a standards-level issue. Some respondents did not agree with the explanation in CF–ED2, and expressed a view that noting that the Conceptual Framework should provide guidance for use at the standards level on whether stand-ready obligations can give rise to liabilities in certain circumstances. The IPSASB remains of the view that the Conceptual Framework should not specify the circumstances in which stand-ready obligations of a public sector entity would give rise to a liability. The following paragraph outlines some public sector circumstances that have led to the IPSASB’s view on this matter.

BC21. A public sector entity’s obligation to transfer resources to another entity in particular circumstances that may occur in the future includes, for example, as a potential lender of last resort and in support of programs that provide a wide range of social benefits. The existence of an obligation to transfer resources to another party in these circumstances may be dependent on ongoing satisfaction of a number of conditions of differing significance and nature that are subject to change by the entity or the government. The IPSASB considers that the circumstances in which liabilities arise as a consequence of the obligation of a public sector entity to transfer resources to other parties consistent with the terms of programs to, for example, provide particular social benefits, and how such liabilities should be described and accounted for, should be considered at the standards level consistent with the principles established in this Conceptual Framework. The IPSASB decided not to use the term stand-ready obligation in the Framework.

Performance Obligations

BC22. A performance obligation is an obligation in a contract or other binding arrangement between a public sector entity and an external party to transfer a resource to that other party. Performance obligations are often explicitly stated in a contract or other agreement and may vary between jurisdictions. Not all performance obligations are explicit. For example, a statutory requirement may give rise to an implicit performance obligation on a public sector entity that is additional to the terms of an agreement or contract.

BC23. A performance obligation also arises when an entity enters into an arrangement whereby it receives a fee and, in return, provides an external party with access to an asset of the...
government. The IPSASB concluded that it is not necessary to identify a specific external party for a performance obligation to arise, but it is important to analyze such obligations in order to determine whether they include a requirement to sacrifice resources. Obligations that require an entity to provide access to a resource, but do not entail an outflow of resources are not performance obligations and do not give rise to liabilities. However, obligations that require an entity to forgo future resources may be liabilities. Performance obligations are often conditional obligations. Determining whether such obligations give rise to liabilities is dependent upon the terms of particular binding agreements and may vary between jurisdictions. The IPSASB concluded that the circumstances under which performance obligations give rise to liabilities should be considered at standards-level.

**Past Event**

**BC24.** The IPSASB considered whether the definition of a liability should require the existence of a past transaction or other event. Some commentators contend that identification of a past event is not an essential characteristic of a liability and that, consequently, there is no need for the definition of a liability to include a reference to a past event. These commentators argue that there may be many possible past events and that establishing the key past event is likely to be arbitrary. They suggest that the existence of a past event is irrelevant in determining whether a liability exists at the reporting date. This view mirrors the opposition to the inclusion of a past event in the definition of an asset, which is discussed in paragraph BC31.

**BC25.** The IPSASB acknowledged this view, but also noted that many respondents to CF–CP2 and CF–ED2 considered it necessary that a past event be identified as a characteristic of a liability. The IPSASB agreed with the view that the complexity of many public sector programs and activities and the number of potential points at which a present obligation might arise means that, although challenging, identification of the key past event that gives rise to a liability is critical in determining when public sector liabilities should be recognized.

**Little or No Realistic Alternative to Avoid**

**Staff comment:** This section reflects the decision to adopt the term "legally-binding obligation" rather than "other binding obligation" at the March 2014 meeting.

**BC26.** Some respondents to CF-ED2 were concerned that the phrase “little or no realistic alternative to avoid” in the description of a present obligation was open to different interpretations. They proposed removal of the words “little or” from this phrase as a means in order to reduce the potential for misinterpretation. The IPSASB considered this proposal but was concerned that the removal of these words may be interpreted as establishing a threshold test of virtual certainty in determining whether a present obligation exists. This was not the intention of the IPSASB. Consequently, the IPSASB confirmed that a present obligation is a legal or non-legal binding requirement that an entity has little or no realistic alternative to avoid.

**BC27.** Interpreting the term “little or no realistic alternative to avoid” in the context of a present obligation is a crucial issue in public sector financial reporting. Determining when a present obligation arises in a public sector context is complex and, in some cases, could be considered arbitrary. This is particularly so when considering whether liabilities can arise from obligations that are not enforceable by legal or equivalent means. In the context of programs to deliver social
benefits there are a number of stages at which a present obligation can arise and there can be significant differences between jurisdictions, even where programs are similar, and over time within the same jurisdiction. For example, different age cohorts are likely to have different expectations about the likelihood of receiving benefits under a social assistance program. Some may be concerned that such variation does not promote consistency in reporting of these obligations as liabilities, and can mean that information reported on liabilities does not meet the QC of understandability. This may lead to a view that an essential characteristic of a liability should be that it is enforceable at the reporting date by legal or equivalent means.

A converse view is that where a government has a record of honoring obligations, failing to recognize them as liabilities leads to an understatement of that government's liabilities. For example, if a government has a consistent record of meeting publicly-announced obligations to provide financial support to the victims of natural disasters, a failure to treat such obligations as liabilities is not in accordance with the objectives of financial reporting and, in particular, does not meet the QCs of faithful representation and relevance.

On balance, the IPSASB agreed with those who argue that, in the public sector, liabilities can arise from binding obligations that the entity has little or no realistic alternative to avoid even if they are not enforceable in law. The IPSASB decided to use the term "other non-legally binding obligations" for such obligations in the Conceptual Framework. However, the IPSASB acknowledged the views of those who are skeptical that liabilities can arise from other than legally enforceable obligations that are not legally enforceable. Consequently, paragraph 3.11 of this Chapter identifies the attributes that an other non-legally binding obligation is to possess for it to give rise to a liability.

The wide variation in the nature of public sector programs and operations and the different political and economic circumstances of jurisdictions globally means that categorical assertions of the circumstances under which obligations not enforceable in law become binding and give rise to present obligations are inappropriate. However, the IPSASB concluded that present obligations are extremely unlikely to arise from election promises. This is because electoral pledges will very rarely (a) create a valid expectation on the part of external parties that the entity will honor the pledge, and (b) create an obligation which the entity has no realistic alternative but to settle. Therefore the Framework includes a presumption that liabilities do not arise from electoral pledges or promises. However, it is accepted that in practice a government with a large majority will be better placed to enact intended legislation than a minority government and that there may be infrequent circumstances where a government announcement in such circumstances like those in BC 32, might give rise to a liability. In assessing whether, in these circumstances, an other non-legally binding obligation gives rise to a liability the availability of funding to settle the obligation may be a persuasive indicator.

Sovereign Power to Avoid Obligations

The sovereign power to make, amend and repeal legal provisions is a key characteristic of governments. Sovereign power potentially allows governments to repudiate obligations arising from both exchange and non-exchange transactions. Although in a global environment such a power may be constrained by practical considerations, there are a large number of examples of governments defaulting on financial obligations over the last century. The IPSASB considered the impact of sovereign power on the definition of a liability. The IPSASB
concluded that failing to recognize obligations that otherwise meet the definition of a liability on the grounds that sovereign power enables a government to walk away from such obligations would be contrary to the objectives of financial reporting and, in particular, may conflict with the QCs of relevance and faithful representation. Many respondents to CF–CP2 and CF–ED2 supported this position. The IPSASB therefore concluded that the determination of whether a liability exists should be by reference to the legal position at the reporting date.

**Commitments**

**BC 38 BC52.** Commitment accounting procedures are a central component of budgetary control for public sector entities in many jurisdictions. They are intended to assure that budgetary funds are available to meet the government’s or other public sector entity’s responsibility for a possible future liability, including intended or outstanding purchase orders and contracts or where the conditions for future transfers of funds have not yet been satisfied. Commitments which satisfy the definition of a liability and the recognition criteria will be recognized in financial statements, in other cases information about them may be communicated in notes to the financial statements or other reports included in GPFRs.

**Section 4: Other resources and other obligations and net financial position**

**Staff comment:** An account of the IPSASB deliberations on deferred flows and reason for deciding to acknowledge that other economic phenomena (other resources and other obligations) may be recognized to meet the objectives of financial reporting is given in paragraphs BC2-BC15.

**BC53.** The reason for acknowledging that other resources and other obligations might be recognized in the financial statements and the IPSASB reason for this conclusion is given in paragraphs BC14.

**BC54.** Net financial position is the aggregate of an entity’s net assets (assets minus liabilities) and other resources and other obligations recognized in the statement of financial position at the reporting date. Where resources and obligations other than those encompassed by the elements are recognized in the financial statements, the amounts reported as net assets and net financial position will differ. In these circumstances, the interpretation of net financial position will be determined by reference to the nature of the additional resources and obligations recognized in the financial statements.

**BC55.** The IPSASB considered whether it should use both the terms ‘net assets’ and ‘net financial position’ in the Framework. The IPSASB acknowledged a view that net assets is a generally
understood term. However, the IPSASB decided that using both terms could be confusing and therefore decided to use the term net financial position to indicate the residual amount of an entity.

Section 54: Revenue and Expenses

Nature of Revenue and Expenses

Staff comment: Section 5 reflects the revised structure of the chapter. It discusses the inclusion of further guidance on financial performance in paragraphs BC64-65 and refers to material previously in paragraph 4.8 and 4.9 of the March version of the draft Chapter.

BC32. BC39 BC56 CF–CP2 explained that one approach to defining revenue and expenses is to take the view that these elements can be derived from changes in assets and liabilities. It noted that this approach has been adopted by many standard-setters globally. CF–CP2 also noted that another view is that revenue and expenses are flows that relate to the current period. CF–CP2 outlined the measures of financial performance that would be presented in financial statements under each approach. There was considerable support for both positions by respondents to CF–CP2.

BC33. BC40 BC57. Consistent with the proposal to define Dis and Dos discussed in paragraphs CF–ED2 reflected a view that revenue and expenses should be defined to focus on the current year activities of the entity. It explained that, in precisely defined circumstances, certain inflows and outflows of resources would not meet the definition of revenue and expenses, but rather are deferred inflows and deferred outflows. CF–ED2 proposed that revenue and expenses should be defined to reflect the inflows of resources used to finance services and the outflows of resources related to providing those services in the reporting period. Consequently, revenues and expenses were defined as inflows and outflows of resources during the period that increased or decrease net assets other than deferred inflows, deferred outflows, ownership contributions and ownership distributions.

BC34. BC41 BC58 As noted in paragraph BC113, a majority of respondents to CF–ED2 did not support the identification of deferred inflows and outflows as elements and the resultant definitions of revenue and expenses. However, some of those respondents acknowledged that the definitions of assets, liabilities, ownership contributions, and ownership distributions included in CF–ED2 and definitions of revenues and expenses derived from changes in assets and liabilities may not capture all the economic phenomena that should be reported in the financial statements or the notions of financial performance that may be useful to users.

BC59. The IPSASB’s decision to acknowledge was persuaded by these arguments and has responded to the views of respondents. The Chapter does not identify deferred inflows and deferred outflows as elements, but acknowledges that IPSASs that deal with particular transactions or other events may require or allow some resources or obligations that do not satisfy the definition of an asset or a liability to be recognized in the financial statements when necessary to achieve the objectives of financial reporting. Consequently, the definitions of revenue and expenses have been revised to encompass transactions and other events that change net financial position, rather than net assets — because in certain circumstances specified by IPSASs, resources and obligations other than assets and liabilities may be recognized in the financial statements. That other resources and other obligations might be recognized in the financial statements required a modification of the
definitions of revenue and expense. The definitions of revenue and expense in section 5 of this chapter reflect this approach.

Gross or Net Increase in “Net Financial Position”

BC35. BC44 BC60.

BC36. The IPSASB is of the view that the concepts applicable to financial reporting, and the notions of financial performance and financial position to be reflected in financial statements will continue to evolve over time in the light of the experience of preparers, users and standard setters. As noted in the Preface, this Conceptual Framework is to be viewed as a living document. Consequently, the identification of elements of financial statements as identified in this document may be developed further in the future.

Staff comment: The Preface to the Conceptual Framework does not currently acknowledge that the Framework is a living document. However, staff is of the view that if Option D is adopted it would be appropriate to include such an observation in the Preface.

Revenue

The IPSASB considered whether the definition of revenue should be the “net” or “gross” increase in “net” financial position. The IPSASB recognized that a “gross” approach would create problems in areas such as the disposal of property, plant, and equipment where such a definition would require the full disposal proceeds to be recognized as revenue, rather than the difference between the disposal proceeds and the carrying amount. Therefore the IPSASB considered that the gross approach is not ideal. The IPSASB acknowledged that standards may require the gross presentation of the relevant flows on the face of the financial statements in certain circumstances, for example, the sale of inventory.

BC37. Distinguishing Ordinary Activities from Activities outside the Ordinary Course of Operations

BC38. BC45 BC61. Some standard setters have structured their definitions of elements so that, for example, inflows and outflows arising from transactions and events relating to activities in the ordinary course of operations are distinguished from inflows and outflows that relate to activities outside the ordinary course of operations. An example of this approach is the definition of revenue, expenses, gains and losses as separate elements, where revenue and expenses relate to entity’s “ongoing major or central operations”, and gains and losses relate to all other transactions, events and circumstances giving rise to increases or decreases in net assets.\(^6\)

BC39. BC46 BC62. The IPSASB acknowledged that distinguishing transactions and events related to the ordinary course of operations from transactions and events outside the ordinary course of operations can provide useful information for users of the financial statements. It may be useful therefore to adopt the terms gains and losses to reflect inflows and outflows from transactions and events outside the ordinary course of operations. However, the IPSASB took the view that, conceptually, gains and losses do not differ from other forms of revenue and expenses, because they both involve net increases or decreases of assets and/or liabilities. The IPSASB also noted that many respondents to CF–CP2 and CF–ED2 shared this view. Therefore the IPSASB decided not to define gains and losses as separate elements.

As discussed in more detail in BC51–BC53BC66-68, the IPSASB considered whether, and, if so, under what circumstances, ownership interests exist in the public sector. In the context of revenue and expenses the IPSASB considered whether transactions related to ownership interests should be excluded from the definitions of revenue and expenses. Because transactions with owners, in their role as owners, are different in substance to other inflows and outflows of resources the IPSASB concluded that it is necessary to distinguish flows relating to owners from revenue and expenses. Therefore ownership contributions and ownership distributions are defined as elements in section 6 of this chapter and excluded from the definitions of revenue and expense.

**Surplus of deficit in the reporting period**

Section 5 of this chapter states that the difference between revenue and expenses is the entity’s surplus or deficit for the period. The IPSASB considered whether it should provide explanatory guidance on the interpretation of surplus or deficit. The IPSASB discussed the view that public sector entities have an operating and funding model, which is the equivalent of the business model in the profit-oriented sector. Relating this model to the surplus or deficit of a period, a surplus would provide an indicator of the ability of the entity to (i) reduce demands for resources from resource providers; (ii) increase either the volume and/or quality of services to recipients; (iii) increase the financial resilience of an entity by reducing debt; or (iv) a combination of these factors. Conversely a deficit provides an indicator of (i) the need to increase demands on resources from resource providers; (ii) reduce either the volume and/or quality of services to recipients; (iii) reduce the financial resilience of the entity by increasing debt, or (iv) a combination of these factors.

The IPSASB acknowledged that there is a need for greater clarity on the meaning of surplus or deficit in the public sector and therefore that these insights should be refined further in the future. However, the IPSASB considered the concept of an operating and funding model or business model is not well developed in the public sector and, further, that operating and funding models may vary globally. The IPSASB therefore decided not to include guidance on the interpretation of surplus or deficit.

**Section 5: Other resources or obligations**

Responses to CF–CP2 and CF–ED2 indicate that measures of financial performance that reflect (a) changes in net assets or net financial position during the reporting period; and (b) the inflows and outflows of flows of resources that relate to the activities of the current period, are both seen as relevant and useful to users of GPFSs. In responding to the views of respondents, the IPSASB considered whether the Conceptual Framework should simply identify the characteristics of the elements and provide guidance on how these elements may be assembled to present information about each of these measures of financial performance. The composition and type of the financial statements that would be used to present the elements, and the measures of performance that they were to reflect, would then be specified at standards level, and may evolve over time and be influenced and enhanced by jurisdictional considerations. However, as noted in paragraph BC4, the IPSASB concluded that while such an approach had merit, the Conceptual Framework should provide clear direction on the elements that were to be recognised in the statement of financial position and statement of financial performance.

In developing this Chapter of the Conceptual Framework the IPSASB considered a number of potential approaches to identifying the elements of financial statements that would best achieve
the objectives of financial reporting and respond to the concerns and views of respondents to CF–CP2 and CF–ED2 and those that provided input at other forums and components of the IPSASB’s consultative process. These approaches are outlined below. The IPSASB acknowledges that each approach has strengths but also some shortcomings. The IPSASB is of the view that the approach reflected in this Chapter is one that allows relevant measures of performance to be presented in GFRSs, best responds to the concerns of constituents and provides a mechanism for financial reporting to further evolve to respond to users information needs.

**BC43.** Approaches considered by the IPSASB and, in some cases explained in CF–CP2 and proposed for adoption in CF–ED2 include:

- Broadening the asset and liability definitions to include deferred inflows and deferred outflows;
- A presentational approach along the lines of “other comprehensive income” (OCI) in International Financial Reporting Standards (IFRSs) would have to be developed and adopted;
- Dealing with deferred inflows and deferred outflows through note disclosure or other forms of communication; and
- Defining deferred inflows and deferred outflows as separate elements.

**BC44.** The IPSASB considered that broadening the definition of an asset and liability distorts the essence of these elements, because it may for example lead to identifying as assets resources that an entity does not, in substance, control and identifying as liabilities obligations that are not present obligations. Such an approach would not be transparent or easily understandable to many users and may conflict with other QCs including relevance and faithful representation. A sub-classification of net assets would only partially compensate for this, because it relegates the results of potentially major flows to a sub-category of the residual amount.

**BC45.** Presentational approaches can be used to provide information about period flows as well as changes in the resources available to support the provision of services in future periods and claims to those resources. A number of respondents to CF–ED2 noted that presenting information about inflows and outflows of resources that relate to the present and/or future periods through note disclosure is not a substitute for their recognition.

**BC46.** Some constituents expressed the view that approaches that define revenue and expenses by reference to changes in assets and liabilities exclude the possibility that in some, albeit rare, circumstances, resources and obligations that arise from some transaction or other events and do not satisfy the definition of any of the elements may need to be recognized to enable the financial statements to provide information useful for accountability and decision purposes. They argue that these circumstances can and do arise and, in the absence of any allowance for their separate recognition such resources and obligations are tenuously or erroneously classified as one of the defined elements, with deleterious effects on transparency and assessments of financial performance and financial position. Some of these constituents note that the Framework should simply acknowledge that this may occur and that it will be dealt with at standards level.

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7 This approach could be supplemented by sub-classifying net assets/net liabilities to include information about deferred inflows and deferred outflows.
BC47. CF-ED2 proposed that Deferred Inflows and Deferred Outflows should be defined as separate elements of the statement of financial position, and provided detailed guidance on the circumstances in which they should be recognized. In the process of finalizing CF-ED2, the IPSASB considered whether deferred inflows and deferred outflows should be identified as elements of the statement of financial performance, and thus allow measures of both changes in net assets and period flows to be presented in that statement. However, the IPSASB rejected this approach because of concerns that it would require recycling of deferred inflows and outflows to revenues and expenses in future periods, and this would unnecessarily complicate and undermine the understandability of the financial statements.

BC48. As noted in paragraph BC3, while some respondents supported the approach proposed in CF-ED2 the majority of respondents did not support identifying DI and DO as elements. The IPSASB has responded to input from constituents. While the Conceptual Framework no longer identifies Deferred Inflows and Deferred Outflows as elements, the IPSASB remains of view that presentation of information about period flows is important and should be addressed through presentation.

Section 6: Net Assets, Net Financial Position, Ownership Contributions, and Ownership Distributions

**Staff comment:** Staff has relocated the section of the Basis for Conclusions to reflect the revised structure of the Chapter and replaced references to ‘net assets’ with ‘net financial position’ and ‘resources’

BC49. Net assets is the difference between assets and liabilities. This Conceptual Framework acknowledges that IPSASs may in some circumstances require the recognition of resources or obligations other than those that satisfy the definition of an element in the statement of financial position. Net financial position is the aggregate of an entity’s net assets and other resources and other obligations recognized in the statement of financial position at the reporting date. The IPSASB anticipates that for most public sector entities the amounts of net assets and net financial position will not differ, or not differ materially. In these cases, net assets/net financial position will represent the resources available for providing services in future periods and the claims against those resources. However, where resources and obligations other than those encompassed by the elements are recognized in the financial statements, the amounts reported as net assets and net financial position may differ. In these circumstances, the interpretation of net financial position and its relationship to net assets will determined by reference to the nature of the additional resources and obligations recognized in the financial statements.

BC50. The IPSASB considered whether net assets or, if appropriate, net financial position is a residual amount, a residual interest or an ownership interest. The IPSASB acknowledged the view that the interest of resource providers and service recipients in the long-term efficiency of the entity, its capacity to deliver services in the future and in the resources that may be available for redirection, restructuring or alternative disposition is similar to an ownership interest. The IPSASB also accepted that the terms residual interest and ownership interest have been used in some jurisdictions to characterize third parties’ interests in net assets. The term residual interest indicates that service recipients and resource providers have an interest in the capability of the entity to finance itself and to resource future operations. The term ownership interest is analogous to the ownership interest in a private sector entity and that
government is responsible to the citizens for the use of those resources. Some argue that this emphasizes the democratic accountability of governments.

The IPSASB took the view that the term residual interest may suggest that service recipients and resource providers have a financial interest in the public sector entity. Similarly the term ownership interest suggests that citizens are entitled to distributions from the public sector entity and to distributions of net assets/resources in the event of the entity being wound up. The IPSASB therefore concluded that the terms residual interest and ownership interest can be misunderstood or misinterpreted, and that net assets and net financial position is a residual amount that should not be defined. Treating net financial position in such a way is more straightforward and understandable.

However, the IPSASB acknowledged that part of net assets or net financial position can in certain circumstances be an ownership interest. Such instances may be evidenced by the entity having a formal equity structure, but there may be instances where an entity is established without a formal equity structure, with a view to sale for operation as a commercial enterprise or by a private sector not-for-profit entity. An ownership interest can also arise from the restructuring of government or public sector entities, such as when a new government department is created. The IPSASB therefore considered whether “ownership interests” should be defined as an element. The IPSASB acknowledged the view that identifying the resources (or claims on future resources) attributable to owners provides information useful for accountability and decision-making purposes. The IPSASB concluded that such interests can be identified through the sub-classification of net assets or net financial position. However, the IPSASB also concluded that it is important to distinguish inflows of resources from owners and outflows of resources to owners, in their role as owners, from revenue, expenses, deferred inflows and deferred outflows, other resources and other obligations. Therefore ownership contributions and ownership distributions are defined as elements. Detailed guidance to support the assessment of whether certain inflows and outflows of resources satisfy the definitions of ownership contributions and ownership distributions can be developed at standards level as appropriate.

**Section 7: Recognition**

**Recognition and its Relationship to the Definition of the Elements**

The IPSASB considered whether all recognition criteria should be integrated in definitions of the elements. The IPSASB acknowledged the view that the inclusion of recognition criteria in definitions of the elements enables preparers to consider all the factors that must be taken into account in evaluating whether an item of information is recognized as an element in the financial statements. However, the IPSASB took the view that while there is overlap in factors to be considered in determining whether an item satisfies the definition of an element and whether that element qualifies for recognition, particularly in respect of whether the recognition criteria of existence uncertainty is met, recognition should be considered as a distinct stage in the financial reporting process. This is because recognition embraces consideration of factors broader than whether the definition of an element is satisfied and may apply to the recognition of items that do not satisfy the definition of an element. The IPSASB also noted that few respondents to CF-CP2 and CF-ED2 supported the integration of recognition criteria in element definitions. After considering this feedback, the IPSASB concluded that element definitions should not include recognition criteria.
Assessing Recognition

BC53. In determining whether an element should be recognized there are two types of uncertainty that need to be considered. The first is existence uncertainty—matters that will have been considered in determining whether an item meets the definition of an element? The second is to consider measurement uncertainty—whether the element can be measured in a representationally faithful manner? The second aspect is only considered if it is determined that the definition of an element has been met.

Existence Uncertainty

BC54. The IPSASB considered whether, in dealing with existence uncertainty, (a) standardized threshold criteria should be adopted, or (b) whether all available evidence should be used to make neutral judgements about an element’s existence.

BC55. Standardized evidence thresholds filter items that have a low probability of resulting in an inflow or outflow of service potential or economic benefits. Such items may have high monetary values and therefore lead to the recognition of elements with significant amounts, even though the probability of existence may be low. Some consider that it would be more appropriate to disclose such items rather than recognize them. Threshold criteria are also justified on cost grounds, because only after a preparer has formed an initial judgement whether those threshold criteria have been met does the preparer consider how that element should be measured.

BC56. The IPSASB formed a view that the adoption of thresholds for recognition purposes risks omitting information that is relevant and faithfully representative and may not meet the QC of comparability, because similar information items may be treated in different ways dependent upon relatively small differences in the probability of a flow of benefits. The IPSASB acknowledges that such risks can also exist for approaches which do not specify thresholds for recognition. This is because preparers will make their own assessments of the circumstances or “the threshold” that justifies recognition and those assessments can change for different items and over time. However, the IPSASB concluded that, on balance, an approach that is based on an assessment of all available evidence in determining whether an element exists and takes account of uncertainty about the flows of service potential or economic benefits in measurement is a more appropriate response to the uncertainty faced by preparers of financial statements. It is more likely to result in the recognition of information that satisfies the QCs than is the establishment of an arbitrary threshold that must be adhered to. Guidance may be provided at standards level on dealing with circumstances in which there is significant uncertainty about whether an element exists in particular circumstances, and therefore would satisfy the criteria for recognition.

BC57. The IPSASB explored whether existence uncertainty is specific to certain components of assets and liabilities, in particular for assets whether an entity controls a resource or a right to a resource and for liabilities whether an entity has little or no realistic alternative to avoid an outflow of service potential or economic benefits. The rationale for this approach is that these are the essential characteristics of an asset and a liability where existence uncertainty is likely to arise.

BC58. The IPSASB took the view that, in the context of assets and liabilities, existence uncertainty relates to more than just these characteristics. Existence uncertainty might also relate to the existence of a present obligation and a past event for liabilities and, in particular, whether a resource that generates future economic benefits or service potential presently exists rather than a future resource or future
right to a resource in the context of an asset. As noted in paragraph BC60 these matters will also have been considered in determining whether an item satisfies the definition of an element.

BC59. The IPSASB also took the view that existence uncertainty is not restricted to just assets and liabilities. While changes in other elements are normally accompanied by changes in assets and liabilities, this may not always be the case. The IPSASB therefore rejected an approach whereby discussion of existence uncertainty is restricted to assets and liabilities.

Measurement Uncertainty

BC60. A range of estimates and measurement techniques may be used to deal with uncertainty associated with the measurement of items that might be presented in the financial statements. In most cases, the application of these measurement and estimation techniques, and the consideration of other relevant information about economic circumstances that exist at reporting date, will result in a measurement that satisfies the QCs. However, in rare circumstances, such as in some legal disputes, it may be that no measure of an asset or a liability would result in a sufficiently faithful representation of that element for it to warrant recognition.

Derecognition

BC61. The IPSASB considered the view that different criteria should be used for initial recognition and derecognition. The IPSASB concluded that adopting differential recognition criteria would conflict with the QC of consistency as it would lead to the recognition of items with different standards of evidence for their existence. Many of the respondents to CF–CP2 and CF–ED2 also supported the use of the same criteria for derecognition as for initial recognition.
Alternative Views

Alternative View of Prof. Mariano D’Amore

AV1. This AV does not question the rationale for recognizing deferred inflows and deferred outflows as elements in the financial statements of a public sector entity. Rather, it debates the treatment of deferred inflows and deferred outflows and their related increases and decreases. This member believes that the treatment proposed in the Exposure Draft (ED) substantially modifies the generally understood concepts of revenue and expenses as changes in net assets, and this may have a negative impact on the users’ understanding of the entity’s financial performance. This AV is based on the assumption that departure from these concepts is not a necessary consequence of the definition of deferred inflows and deferred outflows as separate elements, and that an alternative option may be considered in order to meet the objectives and qualitative characteristics of financial statements. Finally, this AV provides a discussion of the concept of net financial position, since, in this member’s opinion, the ED does not give a satisfactory description of the difference between net assets and net financial position, or the relevance of the latter to meeting users’ needs.

AV2. This member believes that the treatment of deferred inflows and deferred outflows stated in the ED implies a misalignment between revenues and increases in net assets on one side, and expenses and decreases in net assets on the other. Based on the definitions given in the ED, a deferred inflow increases net assets in the year in which the inflow is received and subsequently deferred to future periods (in other words, an increase in deferred inflows is an increase in net assets in the current period). In the year in which a decrease in deferred inflows occurs, this is recognized as revenue, although it is not an increase in net assets in the current period. A deferred outflow decreases net assets in the year in which the outflow occurs and is subsequently deferred to future periods (in other words, an increase in deferred outflows is a decrease in net assets in the current period). In the year in which a decrease in deferred outflows occurs, this is recognized as an expense, although it is not a decrease in net assets in the current period. As a consequence, the difference between revenues and expenses (surplus or deficit for the year) is not intended to equal the change that has occurred in net assets in the reporting period. This member questions whether such a misalignment may mislead users, at least in some jurisdictions.

AV3. In this member’s opinion, the effects on the concept and display of financial performance which arise from the proposed treatment of deferred inflows and outflows, and from the new definition of revenue and expenses, are not fully explained in the ED. Indeed for the ED, revenue and expenses are the only two elements in the Statement of Financial Performance. These are used to aggregate and show under the same headings items which share the feature of being flows related to the reporting period, but which are dissimilar in some other relevant respects. Based on the definition provided in the ED, revenues include inflows which are changes in net assets occurring in the reporting period together with others which are solely movements in deferred inflows. Similarly, some of the expenses are outflows which change net assets in the reporting period while some others are simply movements in deferred outflows. All these flows together are balanced to measure the surplus or deficit for the year. This member thinks that such an approach has a negative effect on faithful representation and the ability of users to assess financial performance by considering its different components, i.e. the elements as defined in the ED.
AV4. It is a generally understood concept that revenue and expenses are flows linked to changes in the stocks of assets and liabilities. So, in this AV, revenues are regarded as aggregating and displaying all, and solely, increases in net assets occurring in the reporting period other than contributions from owners. Similarly, expenses should aggregate and display decreases in net assets occurring in the reporting period other than distributions to owners. Deferred inflows and deferred outflows are still defined as elements in the Statement of Financial Position; thus, they are treated as "stocks" at the end of the reporting period. Increases and decreases in such stocks can be identified as related "flows" occurring in the period. Since deferred inflows and deferred outflows are defined as separate elements from assets and liabilities, increases and decreases in the former should be considered as separate elements from revenue and expenses in the Statement of Financial Performance. Visually (and setting aside ownership contributions/distributions):

Table 1: Elements

<table>
<thead>
<tr>
<th>Stocks</th>
<th>Flows</th>
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<tbody>
<tr>
<td>Assets</td>
<td>Revenue</td>
</tr>
<tr>
<td>Liabilities</td>
<td>Expenses</td>
</tr>
<tr>
<td>Deferred Inflows (from non-exchange transactions)</td>
<td>Increases</td>
</tr>
<tr>
<td>Deferred Outflows (from non-exchange transactions)</td>
<td>Decreases</td>
</tr>
</tbody>
</table>

AV5. As the ED makes a distinction between net assets and net financial position, it should follow that changes in both these stocks be distinguished. Nevertheless, the ED only focuses on the entity’s surplus or deficit for the year as the “primary indicator” of financial performance. In this member’s opinion, change in net assets and surplus/deficit for the year are both relevant performance indicators for accountability and decision-making purposes. Since elements are the basic reference for recording, classifying and aggregating economic data, the approach of defining increases and decreases in deferred inflows/outflows as distinct elements is intended to keep items contributing to different indicators of financial performance separate. Given that how items are displayed is basically a matter of presentation, from a conceptual point of view the relationship between the elements affecting financial performance can be shown as follows:
Table 2: Relationship between the Elements affecting Financial Performance

<table>
<thead>
<tr>
<th>Revenue</th>
<th>Minus Expenses</th>
<th>Equals Change in Net Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Minus Increases in Deferred Inflows</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Plus Increases in Deferred Outflows</td>
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<tr>
<td></td>
<td></td>
<td>Plus Decreases in Deferred Inflows</td>
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<tr>
<td></td>
<td></td>
<td>Minus Decreases in Deferred Outflows</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Equals Surplus or deficit for the year</td>
</tr>
</tbody>
</table>

AV6. Net assets and net financial position differ only because of the deduction from net assets of deferred inflows and the addition of deferred outflows. Deferred inflows are the result of past increases in net assets; specifically, they can be regarded as the part of the net assets which is to be used by the entity under specified timing restrictions. Thus, it may be argued that deducting deferred inflows from net assets shows the net resources available to the entity with no definite timing restrictions. As for deferred outflows, their addition to net assets provides an indicator of the total net resources available to the entity or which have been provided to third parties for the delivery of future services. Taking into account the combined effects of deferred inflows and deferred outflows on the net financial position, the sense of this indicator seems to be unclear, as it may not include net assets which are still available to the entity (in the case of deferred inflows) while encompassing resources which are no longer under the entity’s control (in the case of deferred outflows). Finally, in this member’s opinion, net financial position does not substitute net assets nor is it the primary indicator for the assessment of the net resources available to the entity for the provision of services in the future. Disregarding ownership contributions/distributions, net financial position may however be understood as an accumulated surplus or deficit which gives information about the past capacity of an entity to finance the services it has provided through related revenues.

Alternative View of Ms. Jeanine Poggiolini

AV7. Due to the nature of the activities undertaken in the public sector, there is a high prevalence of non-exchange transactions, which are often significant in individual entities. In exchange transactions, the recognition of revenue and expenses is, in most instances, related to the performance by the parties to the transaction. Due to the inherent nature of non-exchange transactions, there is often no performance required by, or imposed on, the parties to the transaction. To ensure that users of the financial statements have relevant information for decision-making or accountability purposes, these types of transactions require specific consideration by the Board.

AV8. The ED identifies deferred inflows and deferred outflows as separate elements. These elements result from inflows and outflows in non-exchange transactions, where the flows relate to a future period. This member disagrees with the view that deferred inflows and deferred outflows should be identified and recognized as separate elements. Instead, these flows should be included in the definitions of revenues and expenses.

AV9. From a revenue and deferred inflow perspective, when an entity demonstrates control over a resource, and the inflow is not an ownership contribution and no related obligation exists, then
Revenue should be recognized. Where an entity controls the underlying resource and has no related obligation, it has the ability to direct the nature and manner of use of the resulting economic benefits or service potential. As the entity has the ability to control the resource by deciding how, for what and when it can use the associated benefits, it should recognize revenue at that point. The opposite is true for expenses and deferred outflows. If an entity has an outflow of resources over which it has no further control, through, for example, the existence of rights, then an expense should be recognized. In this member’s view, this position more appropriately demonstrates the resources for which the entity is accountable.

AV10. In addition, the existence of other elements in the Framework is based on the occurrence of a past transaction or event. Deferred inflows and deferred outflows, and their subsequent recognition as revenues or expenses, however arise as a consequence of time or the passage of time. In this member’s view, this is not a sound basis for delaying the recognition of revenues and expenses. One of the reasons for delaying the recognition of these revenues and expenses is so that they are used in the period stipulated by the transferor. However, an entity need not use the resources in that period for revenue or expenses to be recognized in that period. This reinforces the view that control either existed or was lost in earlier reporting periods.

AV11. It is however acknowledged that, in certain instances, this approach may result in large surpluses or deficits being reflected in the statement of financial performance. This could be addressed through developing appropriate presentation and disclosure requirements at standards level which would provide relevant information to users of the financial statements. At a more fundamental level, the concepts outlined in the Conceptual Framework should be based on principles that can be applied to a range of transactions and events. As a consequence, these principles should be transaction neutral and should not distinguish between exchange and non-exchange transactions. Moreover, the principles should not be designed and defined in a way so that a specific outcome is achieved for a specific group of transactions.
The IASB Conceptual Framework (September 2010)

Elements and Recognition in Financial Statements

The International Accounting Standards Board (IASB) develops and publishes International Financial Reporting Standards (IFRSs). IFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities.

The IASB Conceptual Framework (issued in 1989 and updated in part in September 2010)\(^4\). It explains:

- The underlying assumption that financial statements are prepared on a going concern basis.
- Financial statements portray the financial effects of transactions and other events by grouping them into broad classes, termed the elements, according to their economic characteristics.
- The elements directly related to the measurement of financial position in the balance sheet are assets, liabilities, and equity. Equity is the residual interest in the assets of the entity after deducting all its liabilities.
- The elements directly related to the measurement of performance in the income statement are income and expenses.
- Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition namely it is probable that any future economic benefit associated with the term will flow to or from the entity and the item has a cost or value that can be measured with reliability.

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\(^4\) The IASB has recently reactivated its Conceptual Framework project. Elements and Recognition is under consideration as part of that project.
Appendix 1B

Statistical Reporting Guidelines of the 1993 System of National Accounts (updated 2008) and Other Guidance derived from it (ESA 95 and GFSM 2001)

Flows and Stocks
The 1993 System of National Accounts (SNA)—as updated in 2008 (SNA 2008):
• Describes the flows and stocks that are recorded in the national economy, including the general government sector and other sectors of the economy. For Government Finance Statistics (GFS) the system explains that all data on units of the general government sector are either flows (mostly transactions) or stocks (assets, liabilities and net worth) before summarizing the accounting rules to record the stocks and flows.
• Covers concepts, definitions, classifications and accounting rules.
• The elements directly related to the measurement of performance in the income statement are revenue and expenses.
• Defines the assets and liabilities included in the system, provides a classification of types of assets and liabilities, and describes the content of each classification category.
• Defines revenue, provides a classification of types of revenue and the contents of each classification category.
• Defines expense and explains the classification between functional and economic expense and the contents of each category.

The GFSM 2001 and ESA 95 are consistent with the principles of the 1993 SNA. However, at a detailed level, some reporting differences may arise as a result of differences in purpose and specific data needs. The GFSM 2001 and ESA 95 are currently under revision to bring them into line with the 2008 SNA.
# Agenda Item 4B.2B

## CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES: ELEMENTS AND RECOGNITION IN FINANCIAL STATEMENTS

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1. **Introduction**

Staff Comment: Reference to recognition in paragraph 1.1 has been deleted, because Recognition is now addressed in Chapter 6.

**Purpose of this Chapter**

1.1 This Chapter defines the elements used in general purpose financial statements (financial statements) of governments and other public sector entities (public sector entities) and provides further explanation about those definitions.

**Elements and their Importance**

1.2 Financial statements portray the financial effects of transactions and other events by grouping them into broad classes which share common economic characteristics. These broad classes are termed the elements of financial statements. Elements are the building blocks from which financial statements are constructed. These building blocks provide an initial point for recording, classifying and aggregating economic data and activity in a way that provides users with information that meets the objectives of financial reporting¹ and contributes to the qualitative characteristics (QCs) of financial reporting.² The elements in the statement of financial position are assets and liabilities. The elements in the statement of financial performance are revenue and expenses. Ownership contributions and ownership distributions are elements of other financial statements included in GPFRs. Determining which definition an item meets will, subject to the satisfaction of recognition criteria, also determine the financial statement in which the item is displayed.

1.3 The elements defined in this Chapter are not the individual items themselves. Sub-classifications of individual items within an element and aggregations of combinations of items are used to enhance the understandability of the financial statements. Presentation is addressed in Chapter 7 *Presentation in General Purpose Financial Reports* of this Conceptual Framework.

1.4 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 of an entity, recognition of economic phenomena that are not captured by the elements as defined in this Chapter may be necessary. Consequently, the identification of the elements in this Chapter does not preclude IPSASs from requiring or allowing the recognition of resources or obligations that do not satisfy the definition of an element identified in this Chapter (hereafter referred to as “other resources” or “other obligations”) when necessary to better achieve the objectives of financial reporting.

**Elements Defined and Approach to Recognition**

Staff Comment: Previous paragraph 1.6 has been deleted in accordance with the direction at the March meeting and references to ‘net assets’ in previous paragraph 1.8 have been deleted. The formula for ‘net financial position’ has been retained, but the narrative description that included a reference to ‘net assets’ has been deleted.

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¹ The objectives of financial reporting, as stated in Phase 1 of the Framework, are to provide information about the entity useful to users for accountability and decision making purposes. *(Staff Comment: This is a staff amendment to better align with the explanation of the objectives in Chapter 2.)*

² The QCs are relevance, faithful representation, comparability, verifiability, timeliness and understandability.
1.5 The elements that are defined in this Chapter are:

(a) Assets;
(b) Liabilities;
(c) Revenue;
(d) Expenses;
(e) Ownership contributions; and
(f) Ownership distributions.

1.6 Net financial position is represented by:

\[
\text{Assets} - \text{Liabilities} + (\text{Other resources} - \text{Other Obligations}) = \text{Net Financial Position}
\]

1.7 Net financial position is defined, but it is not an element. Section 4 discusses net financial position in more detail.
2. **Assets**

**Definition**

2.1 An asset is a resource that an entity presently controls as a result of a past event.

**A Resource**

**Staff Comment:** The reference to ‘an asset’ in paragraph 2.3 has been modified to ‘a resource’ in accordance with the direction at the March 2014 meeting. The reference to “holding cash” in paragraph 2.5 (c) has been deleted because it does not relate to an inflow. Staff does not think that this sub-paragraph needs to be relocated.

Other changes to this section are largely editorial.

2.2 A resource is an item with the ability to provide service potential or economic benefits. Physical form is not a necessary condition of a resource. The service potential or economic benefits can arise directly from the resource itself or from the rights to use the resource. Some resources embody an entity’s rights to a variety of benefits including, for example, the right to:

(a) Use the resource to provide services;

(b) Use an external party’s resources to provide services, for example, leases;

(c) Convert the resource into cash through its disposal;

(d) Benefit from the resource’s appreciation in value; or

(e) Receive a stream of cash flows.

2.3 Service potential is the capacity of to provide services that contribute to achieving the entity’s objectives. Service potential enables an entity to achieve its objectives without generating net cash inflows.

2.4 Public sector assets that embody service potential may include recreational, heritage, community, defense and other assets which are held by governments and other public sector entities and provide services to third parties. Such services may be for collective or individual consumption. Many services may be provided in areas where there is no market competition or limited market competition. The use and disposal of such assets may be restricted. As highlighted in the *Preface to the Conceptual Framework* many assets that embody service potential are specialized in nature.

2.5 Economic benefits take the form of cash inflows or a reduction in cash outflows. Cash inflows (or reduced cash outflows) may be derived from for example:

(a) An asset’s use in the production and sale of services; or

(b) The direct exchange of an asset for cash or other resources;

In addition, a resource may be used to settle a liability or to make an ownership distribution.

---

3 References to “services” in this Conceptual Framework encompass “goods and services”.
An Entity Controls

Staff Comments: The last sentence of paragraph 2.7 has been deleted in accordance with directions at the March 2014 meeting.

While the IPSASB confirmed the decision not to define a past event at the March 2014 meeting it directed that the point about identifying the past event should be made more prominent. The sequence of the sentences in paragraph 2.8 has therefore been amended.

2.6 An entity must have control of the resource. Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.

2.7 In assessing whether it controls a resource, an entity assesses whether the following indicators of control exist:

(a) Legal ownership;
(b) Access to or, conversely, the ability to deny or restrict access to the resource;
(c) The means to ensure that the resource is used to achieve its objectives; and
(d) The existence of an enforceable right to service potential or economic benefits arising from a resource.

While these indicators are not conclusive determinants of whether control exists, identification and analysis of them can inform that decision.

Past Event

2.8 The definition of an asset requires that an asset arises from a past transaction or other event. There are a number of potential points at which such events may occur. It is essential to determine the point or event at which transactions, rights or powers give rise to an asset of the entity. Entities can obtain assets by purchasing them in an exchange transaction or producing them. In such cases, identification of the past transaction or other event is straightforward. Assets may also arise through non-exchange transactions, including by exercising sovereign powers. The power to tax or to issue licenses, and to access or restrict or deny access to the benefits embodied in intangible resources like the electromagnetic spectrum, are examples of public sector-specific powers and rights. Taking the example of a tax, the following points in the process may be identified: (a) a general ability to tax, (b) establishment of a power through a statute, (c) exercising the power to create a right, or (d) the taxable event which gives rise to an obligation of another party to pay the tax. When the power is exercised and the rights exist to receive resources, an asset arises.
### 3. Liabilities

**Staff comment:** At the March 2014 meeting, the IPSASB directed that the term “other binding obligation” should be changed to “non-legally binding obligation”. In accordance with the direction at the March meeting the paragraph on “economic coercion” and “political necessity” has been relocated to paragraph 3.6.

Other changes are editorials.

#### Definition

3.1 A liability is a present obligation of an entity for an outflow of resources that results from a past event.

**A Present Obligation**

3.2 A present obligation is a legal or other binding requirement which an entity has little or no realistic alternative to avoid.

**An Outflow of Resources from the Entity**

3.3 A liability must involve an outflow of resources from the entity in order to settle it. An obligation that can be settled without an outflow of resources from the entity is not a liability.

**Past Event**

3.4 The complexity of public sector programs and activities means that there are a number of potential points in the development, implementation and operation of a program at which a present obligation may arise. This is particularly the case for binding requirements that the entity has little or no realistic alternative to avoid but are not legally enforceable (referred to as “non-legally binding obligations” in this Conceptual Framework). To satisfy the definition of a liability, it is necessary that a present obligation arises as a result of a past event and requires an outflow of resources from the entity. Where an arrangement has a legal form, such as a contract, a past event may be straightforward to identify. In other cases, it may be more difficult to identify the past event and identification involves analysis of when an entity has little or no realistic alternative to avoid an outflow of resources from the entity.

**Little or No Realistic Alternative to Avoid**

**Legal and Non-Legally Binding Obligations**

3.5 Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations can arise from both exchange and non-exchange transactions. An obligation must be to an external party in order to give rise to a liability. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Identification of the external party is an indication of the existence of an obligation giving rise to a liability. However, it is not essential to know the identity of the external party before the time of settlement in order for a present obligation and a liability to exist.

3.6 “Economic coercion”, “political necessity” or other circumstances may give rise to situations, where, although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may not have a realistic
alternative but to incur such an outflow. Economic coercion, political necessity or other circumstances may, lead to a liability arising from a non-legally binding obligation (see paragraphs 3.11–3.13).

3.7 Many arrangements that give rise to an obligation include settlement dates. The inclusion of a settlement date may provide an indication that an outflow of resources gives rise to a liability. However, there are many agreements that do not contain settlement dates. The absence of a settlement date does not preclude an obligation giving rise to a liability.

Legal Obligations

3.8 A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent. There are jurisdictions where government and public sector entities cannot have legal obligations because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in this Framework. For some types of non-exchange transactions, judgment will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law there can be no doubt that an entity has no realistic alternative to avoid the obligation and that a liability exists.

3.9 Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date, but will be enforceable with the passage of time without the external party having to meet further conditions—or having to take any further action—prior to settlement. Claims that are unconditionally enforceable subject to the passage of time are enforceable obligations in the context of the definition of a liability.

3.10 Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this Framework and therefore cannot be recognized. The legal position should be assessed at each reporting date to consider if it has changed and to determine whether a liability still exists.

Non-Legally Binding Obligations

3.11 Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give rise to liabilities have the following attributes:

(a) The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;

(b) As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and

(c) The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

References to obligations enforceable in law encompass legal obligations and binding obligations subject to alternative processes with equivalent effect.
3.12 In the public sector, obligations may arise at a number of points. For example, there are a number of early points in implementing a program or service, including:

(a) Making a political promise such as an electoral pledge;
(b) Announcement of a policy;
(c) Introduction (and approval) of the budget (which may be two distinct points); and
(d) The budget becoming effective (in some jurisdictions the budget will not be effective until an appropriation has been effected).

3.13 These early stages are unlikely to give rise to obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to obligations that meet the definition of a liability. The point at which an obligation gives rise to a liability critically depends on the nature of the obligation. Indicators that are likely to impact on judgments about whether the obligation is one that other parties can validly conclude that the entity has little or no realistic alternative to avoid an outflow of resources include:

(a) The nature of the past event or events that give rise to the obligation. For example, a promise made in an election is unlikely to give rise to a present obligation because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it has little or no realistic alternative to avoid settling. However, an announcement made in the legislature by a majority government, particularly one with all party support, in relation to an event or circumstance that has occurred, and where the government has committed to introduce and secure passage of the necessary budgetary provision may, or may not, give rise to a non-legally binding obligation.

(b) The ability of the entity to modify or change the obligation before it crystallizes. For example, the announcement of policy will generally not give rise to a non-legally binding obligation which cannot be modified before being implemented. Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before those events occur.

(c) There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, there is a presumption that a non-legally binding obligation exists. However the absence of a budgetary provision is not, of itself, a reason for not recognizing a liability.
4. Other Resources and Other Obligations and Net Financial Position

Staff comment: In accordance with directions at the March 2014 meeting the sections on other Resources, Other Obligations and Net Financial Position have been combined and brought forward before the section on Revenue and Expense.

Other Resources and Other Obligations

4.1 Chapter 2 of the Conceptual Framework identifies the objectives of financial reporting as the provision of information useful for accountability and decision-making purposes, outlines the information users will need for those purposes and explains the role of financial statements and other GPFRs in providing such information. Chapter 2 notes that for accountability and decision-making purposes users will need information about such matters as:

(a) The performance of the entity during the reporting period in meeting its service delivery and financial objectives, managing the resources it is responsible for, and complying with relevant budgetary and other authority regulating the raising and use of resources; and

(b) The liquidity and solvency of the entity and the sustainability of the entity’s service delivery and other operations over the long term, and changes therein as a result of the activities of the entity during the reporting period including, for example, changes to its financial and operating capacity.

4.2 In some cases, in developing or revising an IPSAS, the IPSASB may determine that to achieve the objectives of financial reporting a resource or obligation that does not satisfy the definition of an element should be recognized in the financial statements. In these cases, the IPSAS may require or allow these resources or obligations to be recognized as “other resources” or “other obligations”, being classes of items additional to the elements.

Net Financial Position

4.3 Net financial position is the difference between assets and liabilities after adding other resources and deducting other obligations recognized in the statement of financial position. As noted in paragraph 1.6, net financial position is not an element.

4.4 All items that meet the definition of assets and liabilities, and satisfy the recognition criteria set out in Chapter 6 are reported on the statement of financial position. Except where an IPSAS requires or allows items that do not satisfy the definition of an asset or liability to be recognized in the statement of financial position as other resources or other obligations, net financial position is the difference between assets and liabilities. Net financial position can be a positive or negative residual amount.
5. **Revenue and Expense**

Staff comments:

In the March 2014 draft this section was section 4. It has been relocated after the combined section 4 on other resources, other obligations and net financial position.

At the March 2014 meeting the IPSASB directed that the definitions of revenue and expense should be simplified. The revised definitions respond to that direction.

Paragraphs 4.3 and 4.5 in the March version has been deleted in accordance with directions at that meeting.

Paragraphs 4.8 and 4.9 have been deleted in accordance with directions at that meeting. A discussion of this material has been included in the Basis for Conclusions.

**Definitions**

5.1 Revenue is:

(a) Increases in net financial position of an entity, other than ownership contributions; and

(b) Reductions in amounts recognized as other obligations in previous reporting periods.

5.2 Expense is:

(a) Decreases in the net financial position of an entity, other than ownership distributions; and

(b) Reductions in amounts recognized as other resources in previous periods.

5.3 Revenue and expense can arise from exchange and non-exchange transactions, other events such as price changes, unrealized increases and decreases in the value of assets and liabilities, and the consumption of assets through depreciation and erosion of service potential and economic benefits through impairments. They may arise from individual transactions or groups of transactions.

**Surplus or deficit for the Period**

5.4 All items that meet the definition of revenues and expenses and the recognition criteria set out in Chapter 6 are reported on the statement of financial performance. The difference between revenue and expenses is the entity’s surplus or deficit for the period.
6. **Ownership Contributions, and Ownership Distributions**

| Staff Comment: | References to “net assets of the entity” have been changed to “net financial position”. The section on Net Financial Position has been relocated to Section 4. Staff has changed the reference to “net assets” in paragraph 6.5 to “resources”. |

**Definitions**

6.1 Ownership contributions are inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity.

6.2 Ownership distributions are outflows of resources from the entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the net financial position of the entity.

6.3 It is important to distinguish inflows of resources from owners, including those inflows that initially establish the ownership interest, and outflows of resources to owners in their capacity as owners, from revenue and expenses. In addition to the injections of resources and dividend payments that may occur, in some jurisdictions it is relatively common for assets and liabilities to be transferred between public sector entities for no consideration. Where such transfers satisfy the definitions of ownership contributions or ownership distributions they will be accounted for as such.

6.4 Ownership interests may arise on the creation of an entity when another entity contributes resources to provide the new entity with the capacity to commence operational activities. In the public sector, contributions to, and distributions from, entities are sometimes linked to the restructuring of government and will take the form of transfers of assets and liabilities rather than cash transactions. Ownership interests may take different forms, which may not be evidenced by an equity instrument.

6.5 Ownership contributions give a right to a return or increased return to owners, and may take the form of an initial injection of resources at the creation of an entity or a subsequent injection of resources, including injections in the event of the entity being restructured. The return to owners may be either a) a return on investment; b) a return of investment; or, c) in the event of the entity being wound up or restructured, a return of any resources.

| Staff Comment: | Section 7 on Recognition has been transferred to a separate chapter. See Agenda Items 4B.3A and 4B.3B. |
Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

Section 1: Introduction

BC1. Respondents to the Conceptual Framework, Consultation Paper, *Elements and Recognition in Financial Statements* (CF–CP2), which was issued in December 2010, questioned why the IPSASB was only addressing elements for the financial statements in this phase of the Framework. They suggested that IPSASB should also develop elements for economic phenomena in the “more comprehensive” areas of financial reporting outside the financial statements, as outlined in Chapter 1 of the Framework. The IPSASB acknowledged the merits of these views and agrees that there is a need to develop such elements in the future. The IPSASB, however, decided that in order to put its future standard-setting activities for the financial statements on a sound and transparent footing it is important to deal firstly with the development of elements for the financial statements.

Elements and Financial Performance

Staff Comment: Following discussion at the March meeting this section has been replaced by material taken from the Background section of the Issues Paper from the March 2014 meeting.

*Conceptual Framework Consultation Paper, Elements and Recognition in Financial Statements (CF–CP3)*

BC2. CF–CP2 discussed two contrasting approaches to financial performance:

- An approach that measures financial performance as the net result of all changes in the entity’s resources and obligations during the period (described as the asset and liability-led approach (A & L-led approach)); and
- An approach that measures financial performance as the result of the revenue inflows and expense outflows more closely associated with the operations of the current period (described as the revenue and expense-led approach) R & L-led approach.

BC3. CF–CP2 noted that the two different approaches could lead to different definitions of the elements related to financial performance and financial position. The R & E-led approach is strongly linked to the notion of inter-period equity. Inter-period equity refers to the extent to which the cost of providing programs and services in the reporting period is borne by current taxpayers and current resource providers. The A & L-led approach is linked to the notion of changes in resources available to provide services in the future and claims on these resources as a result of period activity.

BC4. A further section of CF–CP2 discussed “Other Potential Elements” and pointed out that, if IPSASB adopted the R & L-led approach, IPSASB would need to address deferred flows. Under this approach deferred flows are items that do not meet the proposed definitions of revenue and expense, but which are nevertheless considered to affect the financial performance of the period. CF–CP2 identified three options for dealing with deferred flows:

- Defining deferred inflows (DIs) and deferred outflows (DOs) as elements on the statement of financial position;
- Broadening the asset and liability definitions to include items that are deferrals; or
- Describing deferred flows as sub-classifications of net assets/net liabilities (subsequently referred to as the residual amount).

BC5. CF–CP2 had two specific matters for comment (SMC) on these areas. The first asked constituents to indicate whether they preferred the A & L-led or R & E-led approach and to indicate their reasons. The second asked whether deferrals need to be identified on the statement of financial position. If respondents supported such identification on the statement of financial position they were asked to indicate which of the three approaches in paragraph BC4 they supported.

BC6. The responses to these SMCs were inconclusive. A small majority of respondents expressing a view favored the A & L-led approach. However, a number of respondents who supported the A & L-led approach also indicated that they favored identifying deferrals on the statement of financial position.

Conceptual Framework Exposure Draft, Elements and Recognition in Financial Statements (CF–ED2)

BC7. Following extensive discussions in the second half of 2011 and the first half of 2012 the IPSASB issued CF–ED2 in November 2012. CF–ED2 expressed a view that it is important to be able to distinguish flows that relate to the current reporting period from those that relate to specified future reporting periods. CF–ED2 therefore proposed definitions of a DI and DO as follows:

- A deferred inflow is an inflow of service potential or economic benefits provided to the entity for use in a specified future reporting period that results from a non-exchange transaction and increases net assets; and
- A deferred outflow is an outflow of service potential or economic benefits provided to another entity or party for use in a specified future reporting period that results from a non-exchange transaction and decreases net assets.

BC8. The two key features of these definitions were;

i. The proposed elements were restricted to non-exchange transactions; and
ii. The flows had to be related to a specified future period.

BC9. The IPSASB’s rationale for including these characteristics were as risk-avoidance measures to (i) reduce the possibility of DIs and DOs being used widely as smoothing devices and (ii) to ensure that DIs and DOs are not presented on the statement of financial position indefinitely. Two Alternative Views (AVs) contested the approach to DIs and DOs.

BC10. A SMC in CF–ED2 asked constituents whether they agreed with the decision to define DIs and DOs as elements. Respondents who supported the decision to define DIs and DOs were further asked whether they specifically supported the restriction to non-exchange transactions and more broadly whether they supported the proposed definition.

BC11. Most of the respondents to CF–ED2 disagreed with defining DIs and DOs as elements. Many respondents opposed to these elements, expressed reservations about the implications for convergence/alignment with the International Accounting Standards Board’s Conceptual Framework, and International Financial Reporting Standards more generally A number of respondents considered that the proposed approach did not reflect economic reality and that it would be more difficult to determine an objective basis for deferring revenue and expenses under
the R&L-led model. Nevertheless, a number of respondents also expressed the view that information on flows relating to particular reporting periods has information value.

BC12. The rationale for restricting the definitions to non-exchange transactions was challenged as conceptually weak both by respondents who favored defining DIs and DOs as elements and those opposed to these proposed elements. Respondents also challenged the restriction to specified time periods because it would potentially lead to the different accounting treatment of very similar transactions dependent upon whether a specific period was identified; i.e., a grant without conditions receivable by an entity to finance its general activities for a five year period would have met the definition of a DI, whereas a similar grant for a future unspecified period would have met the definition of revenue.

Finalizing the Elements Chapter

BC13. The IPSASB had to decide how to proceed in drafting the chapter on elements. The IPSASB needed to balance the limited support for the proposals on deferred flows in CF-ED2, with a view that it needed to respond to the perceived needs of users for information about flows relating to particular reporting periods.

BC14. The IPSASB therefore considered five options for the approach to be adopted in the Elements chapter:

A. Defining DIs and DOs as elements in a more principles-based manner and not specifying the financial statements in which the elements are to be recognized. As such, the Chapter would not predetermine the presentation of the elements;
B. Deriving the definitions of revenues and expenses from the asset and liability definitions;
C. Broadening the asset and liability definitions;
D. Accepting that certain economic phenomena that do not meet the definition of any element may need to be recognized in financial statements in order to meet the objectives of financial reporting; and
E. Reporting inflows and outflows that provide service potential or economic benefits, but do not affect assets and liabilities as defined in the Framework and reporting inflows and outflows that do not affect revenue and expenses.

BC15. The IPSASB concluded that it should adopt Option D. It considers that this option acknowledges that there may be circumstances under which the elements may not provide all information in the financial statements for meeting the needs of users and that it is transparent to accept that other items may be recognized. This approach does not involve defining new elements, unlike Option A, and does not involve significant modification of existing definitions of an asset and a liability, unlike Option C. The overarching term “other economic phenomena” been used in section 1 of this chapter to describe such items and the more detailed terms “other obligations” and “other resources” have been used in subsequent sections. The circumstances under which “other obligations and other resources” will be recognized will be determined at standards-level and explained in the Bases for Conclusions of specific standards.

Financial Statements

BC16. This Conceptual Framework identifies the elements of the statement of financial position and statement of financial performance. The IPSASB considered whether this Chapter of the Conceptual Framework should focus on only the definition and explanation of the elements without
specifying the financial statements in which those elements are to be recognised. The IPSASB noted that such an approach would allow for the ongoing development of the financial statements that might present information about financial performance and financial position. However, the IPSASB concluded that while such an approach had merit, the statement of financial position and statement of financial performance were, or were often perceived to be, the primary vehicles for communicating information about financial position and performance to users of GPFRs, and the Conceptual Framework should provide clear direction on the elements to be recognised in them.

Section 2: Assets

A Resource

BC17. In the public sector, an asset is a resource with the ability to provide service potential or economic benefits. The inflow of resources to an entity contributes to the operating capacity of the entity and therefore its ability to provide services in the future. This Conceptual Framework confirms that physical form is not a necessary condition of an asset. Many assets, such as buildings, equipment and inventories are tangible, while others, such as current rights are intangible. Financial assets, such as bonds and derivatives are a further category of assets that do not have physical form.

BC18. The IPSASB recognized that other rights to service potential or economic benefits may not be directly associated with a particular tangible, intangible or financial resource. An example is the right to require other parties to perform in a certain way by, for example, making payments or providing services in a manner specified by the entity. One or more public sector entities may also share in the benefits under a joint venture arrangement with another entity.

Unconditional Rights and Executory Contracts

Staff Comment: Following a direction at the March meeting Staff has inserted a paragraph on the reason why the Basis for Conclusions includes discussion of unconditional rights and executory contracts, noting that these areas are not considered in the core text.

BC19. CF–ED2 discussed unconditional rights and executory contracts. The IPSASB considered whether the Framework should specifically address unconditional rights and executory contacts.

BC20. Unconditional rights typically result from contracts or other binding arrangements that require provision of resources to the entity in the future. The IPSASB noted that there can be a large number of such rights and concluded that unconditional rights that represent service potential or economic benefits that are controlled by the entity as a result of a past event give rise to assets. Whether such assets qualify for recognition will be dependent on whether recognition criteria have been satisfied. The IPSASB concluded that the Framework should not specifically address unconditional rights.

BC21. Executory contracts are binding arrangements, where there is an unconditional promise to receive resources and an equal promise to transfer resources to the counterparty in the future. Public sector entities are likely to engage in a large number of such arrangements. The IPSASB acknowledged the view that such arrangements may give rise to both assets and liabilities, as the promise to receive benefits is likely to have value and the promise to transfer benefits involves a present obligation to sacrifice resources, which the entity has no realistic alternative to avoid. The IPSASB also acknowledged the view that recognizing assets and liabilities from executory contracts would
involve the inclusion of potentially very large offsetting amounts in the statement of financial position and the statement of financial performance and that this may conflict with the QC of understandability. Whether assets and liabilities arise from rights and obligations in executory contracts will be determined by an assessment of whether those rights and obligations satisfy the definitions and recognition criteria identified in this Conceptual Framework. Such assessments and mechanisms for presentation in financial statements of any elements arising from executory contracts that best satisfy the QCs will be considered at standards level. The IPSASB therefore decided not to address executory contracts specifically in the Framework.

Service Potential and Economic Benefits

BC22. The term “service potential” has been used to identify the capacity of an asset to provide services in accordance with an entity’s objectives. The term “economic benefits” has been used to reflect the ability of an asset to generate net cash inflows. Some argue that economic benefits includes service potential, others argue that service potential includes economic benefits, and still others consider that the terms can be used interchangeably. The IPSASB considered whether in the context of the substance of an asset, the explanation of a resource should include a reference to both service potential and economic benefits, and decided that it should. In making this decision, the IPSASB acknowledged the view that economic benefits includes service potential and also considered the converse view that because the primary objective of public sector entities is the delivery of services, generally in non-exchange transactions, service potential should be separately identified. The IPSASB noted that many respondents to CF–CP2 and CF-ED2 supported inclusion of a specific reference to service potential.

BC23. The IPSASB therefore concluded that because the primary objective of most public sector entities is to deliver services, but also in acknowledgment of the fact that public sector entities may carry out activities with the sole objective of generating net cash inflows, the explanation of a resource should include both the terms service potential and economic benefits.

An Entity Controls

BC24. The IPSASB considered whether “control” is an essential characteristic of an asset or whether other indicators such as the following should be identified as essential characteristics of an asset: (a) legal ownership; (b) the right to access, and to restrict or deny the access of external parties to, the resource; (c) the means to ensure that the resources are used to achieve its objectives; and (d) the existence of enforceable rights to service potential or economic benefits arising from a resource. The IPSASB acknowledged the views of those who argue that control may be difficult to apply in some cases because it requires judgment to assess whether control exists. In addition, control can be erroneously applied to a resource in its entirety and not to the individual benefits that accrue from the resource. However, notwithstanding such difficulties, the IPSASB concluded that control is an essential characteristic of an asset because the presence of control facilitates the association of an asset with a specific entity, particularly in the public sector environment.

BC25. Legal ownership of the underlying resource, such as a property or item of equipment, is one method of accessing the benefits provided by an asset. However, rights to benefits may exist without legal ownership of the underlying resource. For example, the rights to the benefits through the holding and use of leased property are accessed without legal ownership of the leased asset itself.
Therefore, legal ownership is not an essential characteristic of an asset. Legal ownership is, however, an indicator of control.

BC26. The right to access a resource may give an entity the ability to determine whether to (a) directly use the resource’s service potential to provide services to beneficiaries, (b) exchange the benefits for another asset, such as cash, or (c) use the asset in any of the other ways that may provide benefits. While it might be questioned whether a resource that cannot be used to meet an entity’s objectives gives rise to an asset, such a resource could be exchanged for an alternative and more appropriate resource.

BC27. While access to a resource is crucial, there are resources to which an entity has access which do not give rise to assets, such as air. Therefore, the ability to access a resource must be supplemented by the ability to deny or restrict the access of others to that resource. For example, (a) an entity might decide whether to set an entrance fee to a museum, and (b) government may control a natural resource under its land to which it can restrict the access of others. Legally enforceable claims to specific benefits such as right of road access or to explore land for mineral deposits could represent an asset to the holder. However an entity may be able to access the service potential or economic benefits associated with a resource in ways other than legal rights. For example, an entity may be able to ensure continuing access to specific rights by imposing effective economic or social sanctions on other parties.

BC28. The IPSASB took the view that the factors identified in paragraph BC24 are likely to be persuasive indicators of the existence of control rather than essential characteristics. For example, the inability of an entity to restrict or deny access of some external parties to a resource may raise doubts about whether the resource constitutes an asset of the entity.

BC29. The IPSASB also considered whether the economic ownership approach is a viable alternative to the control approach. The economic ownership approach focuses on an entity’s exposure to the underlying economic attributes that contribute to an asset’s value to the entity. Some respondents to CF–CP2, in supporting the control approach, commented on the complexity of the economic ownership approach. The IPSASB concluded that the economic ownership approach is subjective and difficult to operate and therefore rejected this approach.

BC30. The IPSASB then considered whether an analysis of exposure to the risks and rewards of ownership is a useful indicator of control. The IPSASB decided not to include it as an indicator of control. The control approach focuses on the power of the entity to direct how the resource is used so as to benefit from the service potential and/or economic benefits embodied in the resource. The risks and rewards approach focuses on an entity’s exposure to the underlying economic attributes that contribute to an asset’s value to the entity and the related risks. Consideration of the risks and rewards associated with particular transactions and events, and which party to any transaction or event bears the majority of those risks and rewards, may be relevant and useful in identifying the nature of the asset controlled by parties to the transaction or event. It may also be useful in determining how to quantify and associate the economic rights and obligations with particular parties. However, it is not of itself an indicator of which party controls an asset which operates to provide services to other parties, particularly when many of those services are provided in non-exchange transactions. In these cases, identifying which party bears the majority of the “risks” and receives the majority of the “rewards” associated with a resource is not necessarily an indicator of which party has the capacity to direct how the resource is used so as to meet its service delivery
objectives. In addition, given the range and nature of commercial and social risks and rewards that are associated with many resources of public sector entities, it is not clear how the various risks and rewards can be weighted and aggregated to provide a useful indicator of which party bears the majority of those risks and rewards.

Past Event

BC31. Some argue that identification of a past transaction or other event which gives rise to the asset is an essential characteristic of an asset. Others take the view that the identification of a past event is not necessary and should not therefore be an essential characteristic of an asset. They consider that such a requirement places undue emphasis on identifying the past event that gave rise to an asset. Such emphasis may be a distraction and lead to debates about which event is the triggering event instead of the more important issue of whether the rights to resources exist at the reporting date. Those who take this view consider that the essential characteristic of an asset should be the existence of a resource. Some may also accept that a past event might provide useful supporting evidence of the existence of an asset, but not that it should be an essential characteristic.

BC32. Many respondents to CF–CP2 and CF-ED2 took the view that a past event should be identified as an essential characteristic of the definition of an asset. The IPSASB agreed with these respondents. In particular, the IPSASB considered that the complex nature of many public sector means that there are a number of points at which a resource might arise and therefore identification of the appropriate past event is crucial in identifying whether an asset exists.

BC33. As highlighted in the Preface to the Conceptual Framework, the powers and rights of government are particularly significant for the identification of assets. Assets may be created in non-exchange transactions, and by virtue of the exercise of sovereign powers. The power to tax and issue licenses, and other powers to access or to deny or restrict access to the benefits embodied in intangible resources like the electromagnetic spectrum are examples of public-sector specific powers. Given the significant powers that accrue to sovereign governments and, in certain circumstances, other public sector entities, it is often difficult to determine when such powers give rise to a right that is a resource and asset of the entity.

BC34. A government’s power to establish a right to levy a tax or fee, for example, often begins a sequence of events that ultimately results in the flow of economic benefits to the government. The IPSASB considered two views of when an asset arises from the powers and rights of government. The first view is that the government has an inherent power to tax at every reporting date and, therefore, that the general ability to levy taxes or fees is an asset. Proponents of this view accept that such an asset is unlikely to be capable of faithfully representative measurement, but argue that this should not deflect from an acknowledgement that government has a perpetual asset. The countervailing view is that the power to levy taxes and fees must be converted into a right by legal means and that such a right must be exercised or exercisable in order for an asset to come into existence. Many respondents to CF–CP2 and CF-ED2 supported this latter view. The IPSASB agreed with these respondents. In particular, the IPSASB considered that a government’s inherent powers do not give rise to assets until these powers are exercised and the rights exist to receive service potential or economic benefits.
Section 3: Liabilities

A Present Obligation

Staff comment: Staff has added additional wording to paragraph BC35 to refer to the view that the term “non-legally binding obligations” refers to potentially illegal obligations and the rejection of such a view by the IPSASB.

Staff has added paragraph BC36 as a lead-in to the discussion of conditional, unconditional stand-ready obligations and performance obligations.

A sentence has been added to paragraph BC 39 stating that stand-ready obligations are a type of conditional obligation.

BC35. In considering when obligations are present obligations, the IPSASB accepted that a legal obligation gives rise to a present obligation. In some jurisdictions, public sector entities are not permitted to enter into certain legal arrangements, but there are equivalent mechanisms. Such mechanisms are considered legally binding. The IPSASB then considered how to classify obligations that were not legal obligations. The IPSASB noted that “constructive obligations” is a term embedded in standard setting literature globally and has been used in IPSAs. However, it has proved difficult to interpret and apply in a public sector context. Therefore, the IPSASB considered alternative terminology, for example the term “a social or moral duty or requirement.” The IPSASB was concerned that the term “social” might be confused with political values and that the term “moral obligations” risks a perception that standard setters and preparers are arbiters of morality. The IPSASB therefore decided that making a distinction between legal and “non-legally binding obligations” was the most straightforward and understandable approach. The IPSASB considered and rejected the view that the term “non-legally binding obligations” refers to obligations, the legality of which is questionable. Paragraph BC3 discusses non legally-binding obligations.

BC36. In the context of a present obligation the IPSASB considered conditional and unconditional obligations, stand-ready obligations and performance obligations.

Conditional and Unconditional Obligations

BC37 An unconditional obligation is one that stands on its own, independent of future events. A conditional obligation relies on the possible occurrence of a future event which may or may not be under the control of the reporting entity. The IPSASB concluded that it is possible for conditional obligations to give rise to liabilities as defined in this Conceptual Framework. Determining whether a conditional obligation satisfies the definition of a liability will involve consideration of the nature of the obligation and the circumstances in which it has arisen. Given the complexity of public sector programs and activities, whether the past event (or events) which has resulted in the entity having no realistic alternative to avoid an outflow of service potential or economic benefits has occurred may not always be clear. Guidance on whether conditional obligations that exist in particular arrangements or circumstances may give rise to liabilities consistent with the definitions identified in this Conceptual Framework is a standards-level issue.

BC38. A variety of terms are used to describe present obligations that may arise from, or exist in conjunction with, conditional obligations in particular circumstances. Amongst these are “stand ready-obligations” and “performance obligations”. The characteristics of these obligations are outlined below.
Stand-Ready Obligations

BC39. Stand-ready obligations are a type of conditional obligation. Stand-ready obligations require an entity to be prepared to fulfill an obligation if a specified uncertain future event outside the entity’s control occurs (or fails to occur). The term stand-ready obligation is used to describe a liability that may arise in certain contractual circumstances, such as those related to insurance, certain financial instruments such as a derivative contract in a loss position, and for warranties where the entity has an obligation to transfer resources if specified future event occurs (or does not occur). In such circumstances, there may be an identifiable past event and an outflow of resources from the entity, although the exact identity of the party to whom settlement will be made will not generally be known. CF–CP2 included a discussion of stand-ready obligations. Many respondents indicated that the distinction between a conditional obligation and a stand-ready obligation is ambiguous.

BC40. CF–ED2 explained that the term stand-ready obligation is not widely used, and does not work well, in the public sector and suggested that whether a stand-ready obligation gave rise to a liability is a standards-level issue. Some respondents did not agree with the explanation in CF–ED2, and expressed a view that the Conceptual Framework should provide guidance for use at the standards level on whether stand-ready obligations can give rise to liabilities in certain circumstances.

BC41. A public sector entity’s obligation to transfer resources to another entity in particular circumstances that may occur in the future includes, for example, as a potential lender of last resort and in support of programs that provide a wide range of social benefits. The existence of an obligation to transfer resources to another party in these circumstances may be dependent on ongoing satisfaction of a number of conditions of differing significance and nature that are subject to change by the entity or the government. The IPSASB considers that the circumstances in which liabilities arise as a consequence of the obligation of a public sector entity to transfer resources to other parties consistent with the terms of programs to, for example, provide particular social benefits, and how such liabilities should be described and accounted for, should be considered at the standards level consistent with the principles established in this Conceptual Framework. The IPSASB decided not to use the term stand-ready obligation in the Framework.

Performance Obligations

BC42. A performance obligation is an obligation in a contract or other binding arrangement between a public sector entity and an external party to transfer a resource to that other party. Performance obligations are often explicitly stated in a contract or other agreement and may vary between jurisdictions. Not all performance obligations are explicit. For example, a statutory requirement may give rise to an implicit performance obligation on a public sector entity that is additional to the terms of an agreement or contract.

BC43. A performance obligation also arises when an entity enters into an arrangement whereby it receives a fee and, in return, provides an external party with access to an asset of the government. The IPSASB concluded that it is not necessary to identify a specific external party for a performance obligation to arise, but it is important to analyze such obligations in order to determine whether they include a requirement to sacrifice resources. Obligations that require an entity to provide access to a resource, but do not entail an outflow of resources are not performance obligations and do not give rise to liabilities. However, obligations that require an entity to forgo future resources may be liabilities. Performance obligations are often conditional obligations. Determining whether such
obligations give rise to liabilities is dependent upon the terms of particular binding agreements and may vary between jurisdictions. The IPSASB concluded that the circumstances under which performance obligations give rise to liabilities should be considered at standards-level.

**Past Event**

**BC44.** The IPSASB considered whether the definition of a liability should require the existence of a past transaction or other event. Some commentators contend that identification of a past event is not an essential characteristic of a liability and that, consequently, there is no need for the definition of a liability to include a reference to a past event. These commentators argue that there may be many possible past events and that establishing the key past event is likely to be arbitrary. They suggest that the existence of a past event is irrelevant in determining whether a liability exists at the reporting date. This view mirrors the opposition to the inclusion of a past event in the definition of an asset, which is discussed in paragraph BC31.

**BC45.** The IPSASB acknowledged this view, but also noted that many respondents to CF–CP2 and CF–ED2 considered it necessary that a past event be identified as a characteristic of a liability. The IPSASB agreed with the view that the complexity of many public sector programs and activities and the number of potential points at which a present obligation might arise means that, although challenging, identification of the key past event that gives rise to a liability is critical in determining when public sector liabilities should be recognized.

**Little or No Realistic Alternative to Avoid**

**Staff comment:** This section reflects the decision to adopt the term “legally-binding obligation” rather than “other binding obligation” at the March 2014 meeting.

**BC46.** Some respondents to CF-ED2 were concerned that the phrase “little or no realistic alternative to avoid” in the description of a present obligation was open to different interpretations. They proposed removal of the words “little or” from this phrase in order to reduce the potential for misinterpretation. The IPSASB considered this proposal but was concerned that the removal of these words may be interpreted as establishing a threshold test of virtual certainty in determining whether a present obligation exists. This was not the intention of the IPSASB. Consequently, the IPSASB confirmed that a present obligation is a legal or non-legally binding requirement that an entity has little or no realistic alternative to avoid.

**BC47.** Interpreting the term “little or no realistic alternative to avoid” in the context of a present obligation is a crucial issue in public sector financial reporting. Determining when a present obligation arises in a public sector context is complex and, in some cases, could be considered arbitrary. This is particularly so when considering whether liabilities can arise from obligations that are not enforceable by legal or equivalent means. In the context of programs to deliver social benefits there are a number of stages at which a present obligation can arise and there can be significant differences between jurisdictions, even where programs are similar, and over time within the same jurisdiction. For example, different age cohorts are likely to have different expectations about the likelihood of receiving benefits under a social assistance program. Some may be concerned that such variation does not promote consistency in reporting of these obligations as liabilities, and can mean that information reported on liabilities does not meet the QC of understandability. This may
lead to a view that an essential characteristic of a liability should be that it is enforceable at the reporting date by legal or equivalent means.

BC48. A converse view is that where a government has a record of honoring obligations, failing to recognize them as liabilities leads to an understatement of that government's liabilities. For example, if a government has a consistent record of meeting publicly-announced obligations to provide financial support to the victims of natural disasters, a failure to treat such obligations as liabilities is not in accordance with the objectives of financial reporting and, in particular, does not meet the QCs of faithful representation and relevance.

BC49. On balance, the IPSASB agreed with those who argue that, in the public sector, liabilities can arise from binding obligations that the entity has little or no realistic alternative to avoid even if they are not enforceable in law. The IPSASB decided to use the term “non-legally binding obligations” for such obligations in the Conceptual Framework. However, the IPSASB acknowledged the views of those who are skeptical that liabilities can arise from obligations that are not legally enforceable. Consequently, paragraph 3.11 of this Chapter identifies the attributes that a non-legally binding obligation is to possess for it to give rise to a liability.

BC50. The wide variation in the nature of public sector programs and operations and the different political and economic circumstances of jurisdictions globally means that categorical assertions of the circumstances under which obligations not enforceable in law become binding and give rise to present obligations are inappropriate. However, the IPSASB concluded that present obligations are extremely unlikely to arise from election promises. This is because electoral pledges will very rarely (a) create a valid expectation on the part of external parties that the entity will honor the pledge, and (b) create an obligation which the entity has no realistic alternative but to settle. Therefore the Framework includes a presumption that liabilities do not arise from electoral pledges or promises. However, it is accepted that in practice a government with a large majority will be better placed to enact intended legislation than a minority government and that there may be infrequent circumstances where a government announcement in such circumstances might give rise to a liability. In assessing whether, in these circumstances, a non-legally binding obligation gives rise to a liability the availability of funding to settle the obligation may be a persuasive indicator.

Sovereign Power to Avoid Obligations

BC51. The sovereign power to make, amend and repeal legal provisions is a key characteristic of governments. Sovereign power potentially allows governments to repudiate obligations arising from both exchange and non-exchange transactions. Although in a global environment such a power may be constrained by practical considerations, there are a large number of examples of governments defaulting on financial obligations over the last century. The IPSASB considered the impact of sovereign power on the definition of a liability. The IPSASB concluded that failing to recognize obligations that otherwise meet the definition of a liability on the grounds that sovereign power enables a government to walk away from such obligations would be contrary to the objectives of financial reporting and, in particular, may conflict with the QCs of relevance and faithful representation. Many respondents to CF–CP2 and CF–ED2 supported this position. The IPSASB therefore concluded that the determination of whether a liability exists should be by reference to the legal position at the reporting date.
Commitments

BC52. Commitment accounting procedures are a central component of budgetary control for public sector entities in many jurisdictions. They are intended to assure that budgetary funds are available to meet the government’s or other public sector entity’s responsibility for a possible future liability, including intended or outstanding purchase orders and contracts or where the conditions for future transfers of funds have not yet been satisfied. Commitments which satisfy the definition of a liability and the recognition criteria will be recognized in financial statements, in other cases information about them may be communicated in notes to the financial statements or other reports included in GPFRs.

Section 4: Other resources and other obligations and net financial position

Staff comment: An account of the IPSASB deliberations on deferred flows and reason for deciding to acknowledge that other economic phenomena (other resources and other obligations) may be recognized to meet the objectives of financial reporting is given in paragraphs BC2-BC15.

BC53. The reason for acknowledging that other resources and other obligations might be recognized in the financial statements and the IPSASB reason for this conclusion is given in paragraphs BC14.

BC54. Net financial position is the aggregate of an entity's net assets (assets minus liabilities) and other resources and other obligations recognized in the statement of financial position at the reporting date. Where resources and obligations other than those encompassed by the elements are recognized in the financial statements, the amounts reported as net assets and net financial position will differ. In these circumstances, the interpretation of net financial position will be determined by reference to the nature of the additional resources and obligations recognized in the financial statements.

BC55. The IPSASB considered whether it should use both the terms ‘net assets’ and ‘net financial position’ in the Framework. The IPSASB acknowledged a view that net assets is a generally understood term. However, the IPSASB decided that using both terms could be confusing and therefore decided to use the term net financial position to indicate the residual amount of an entity.

Section 5: Revenue and Expense

Nature of Revenue and Expense

Staff comment: Section 5 reflects the revised structure of the chapter. It discusses the inclusion of further guidance on financial performance in paragraphs BC64-65 and refers to material previously in paragraph 4.8 and 4.9 of the March version of the draft Chapter.

BC56. CF–CP2 explained that one approach to defining revenue and expenses is to take the view that these elements can be derived from changes in assets and liabilities. It noted that this approach has been adopted by many standard-setters globally. CF–CP2 also noted that another view is that revenue and expenses are flows that relate to the current period. CF–CP2 outlined the measures of financial performance that would be presented in financial statements under each approach. There was considerable support for both positions by respondents to CF–CP2.

BC57. Consistent with the proposal to define Dis and Dos discussed in paragraphs CF–ED2 reflected a view that revenue and expenses should be defined to focus on the current year activities of the
entity. It explained that, in precisely defined circumstances, certain inflows and outflows of resources would not meet the definition of revenue and expenses, but rather are DIs and DOs which should be identified as separate elements of the financial statements. CF–ED2 proposed that revenue and expenses should be defined to reflect the inflows of resources used to finance services and the outflows of resources related to providing those services in the reporting period. Consequently, revenues and expenses were defined as inflows and outflows of resources during the period that increase or decrease net assets other than DIs, DOs, ownership contributions and ownership distributions.

BC58. As noted in paragraph BC11, a majority of respondents to CF–ED2 did not support the identification of DIs and DOs as elements and the resultant definitions of revenue and expenses. However, some of those respondents acknowledged that the definitions of assets, liabilities, ownership contributions, and ownership distributions included in CF–ED2 and definitions of revenues and expenses derived from changes in assets and liabilities may not capture all the economic phenomena that should be reported in the financial statements or the notions of financial performance that may be useful to users.

BC59. The IPSASB’s decision to acknowledge that other resources and other obligations might be recognized in the financial statements required a modification of the definitions of revenue and expense. The definitions of revenue and expense in section 5 of this chapter reflect this approach.

**Gross or Net Increase in “Net Financial Position”**

BC60. The IPSASB considered whether the definition of revenue should be the “net” or “gross” increase in net financial position”. The IPSASB recognized that a “gross” approach would create problems in areas such as the disposal of property, plant, and equipment where such a definition would require the full disposal proceeds to be recognized as revenue, rather than the difference between the disposal proceeds and the carrying amount. Therefore the IPSASB considered that the gross approach is not ideal. The IPSASB acknowledged that standards may require the gross presentation of the relevant flows on the face of the financial statements in certain circumstances, for example, the sale of inventory.

**Distinguishing Ordinary Activities from Activities outside the Ordinary Course of Operations**

BC61. Some standard setters have structured their definitions of elements so that, for example, inflows and outflows arising from transactions and events relating to activities in the ordinary course of operations are distinguished from inflows and outflows that relate to activities outside the ordinary course of operations. An example of this approach is the definition of revenue, expense, gains and losses as separate elements, where revenue and expense relate to entity’s “ongoing major or central operations”, and gains and losses relate to all other transactions, events and circumstances giving rise to increases or decreases in net assets.  

BC62. The IPSASB acknowledged that distinguishing transactions and events related to the ordinary course of operations from transactions and events outside the ordinary course of operations can provide useful information for users of the financial statements. It may be useful therefore to adopt the terms gains and losses to reflect inflows and outflows from transactions and events outside the

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ordinary course of operations. However, the IPSASB took the view that, conceptually, gains and losses do not differ from other forms of revenue and expense, because they both involve net increases or decreases of assets and/or liabilities. The IPSASB also noted that many respondents to CF–CP2 and CF–ED2 shared this view. Therefore the IPSASB decided not to define gains and losses as separate elements.

BC63. As discussed in more detail in BC66-68, the IPSASB considered whether, and, if so, under what circumstances, ownership interests exist in the public sector. In the context of revenue and expense the IPSASB considered whether transactions related to ownership interests should be excluded from the definitions of revenue and expense. Because transactions with owners, in their role as owners, are different in substance to other inflows and outflows of resources the IPSASB concluded that it is necessary to distinguish flows relating to owners from revenue and expenses. Therefore ownership contributions and ownership distributions are defined as elements in section 6 of this chapter and excluded from the definitions of revenue and expense.

Surplus of deficit in the reporting period

BC64. Section 5 of this chapter states that the difference between revenue and expenses is the entity’s surplus or deficit for the period. The IPSASB considered whether it should provide explanatory guidance on the interpretation of surplus or deficit. The IPSASB discussed the view that public sector entities have an operating and funding model, which is the equivalent of the business model in the profit-oriented sector. Relating this model to the surplus or deficit of a period, a surplus would provide an indicator of the ability of the entity to (i) reduce demands for resources from resource providers; (ii) increase either the volume and/or quality of services to recipients; (iii) increase the financial resilience of an entity by reducing debt; or (iv) a combination of these factors. Conversely a deficit provides an indicator of (i) the need to increase demands on resources from resource providers; (ii) reduce either the volume and/or quality of services to recipients; (iii) reduce the financial resilience of the entity by increasing debt, or (iv) a combination of these factors.

BC65. The IPSASB acknowledged that there is a need for greater clarity on the meaning of surplus or deficit in the public sector and therefore that these insights should be refined further in the future. However, the IPSASB considered the concept of an operating and funding model or business model is not well developed in the public sector and, further, that operating and funding models may vary globally. The IPSASB therefore decided not to include guidance on the interpretation of surplus or deficit.

Section 6: Ownership Contributions, and Ownership Distributions

Staff comment: Staff has relocated the section of the Basis for Conclusions to reflect the revised structure of the Chapter and replaced references to ‘net assets’ with ‘net financial position’ and ‘resources’

BC66. The IPSASB considered whether net financial position is a residual amount, a residual interest or an ownership interest. The IPSASB acknowledged the view that the interest of resource providers and service recipients in the long-term efficiency of the entity, its capacity to deliver services in the future and in the resources that may be available for redirection, restructuring or alternative disposition is similar to an ownership interest. The IPSASB also accepted that the terms residual interest and ownership interest have been used in some jurisdictions to characterize third parties’
interests in net assets. The term residual interest indicates that service recipients and resource providers have an interest in the capability of the entity to finance itself and to resource future operations. The term ownership interest is analogous to the ownership interest in a private sector entity and, for some, indicates that the citizens own the resources of the public sector entity and that government is responsible to the citizens for the use of those resources. Some argue that this emphasizes the democratic accountability of governments.

BC67. The IPSASB took the view that the term residual interest may suggest that service recipients and resource providers have a financial interest in the public sector entity. Similarly the term ownership interest suggests that citizens are entitled to distributions from the public sector entity and to distributions of resources in the event of the entity being wound up. The IPSASB therefore concluded that the terms residual interest and ownership interest can be misunderstood or misinterpreted, and that net financial position is a residual amount that should not be defined.

BC68. However, the IPSASB acknowledged that part of net financial position can in certain circumstances be an ownership interest. Such instances may be evidenced by the entity having a formal equity structure, but there may be instances where an entity is established without a formal equity structure, with a view to sale for operation as a commercial enterprise or by a private sector not-for-profit entity. An ownership interest can also arise from the restructuring of government or public sector entities, such as when a new government department is created. The IPSASB therefore considered whether “ownership interests” should be defined as an element. The IPSASB acknowledged the view that identifying the resources (or claims on future resources) attributable to owners provides information useful for accountability and decision-making purposes. The IPSASB concluded that such interests can be identified through the sub-classification of net financial position. However, the IPSASB also concluded that it is important to distinguish inflows of resources from owners and outflows of resources to owners, in their role as owners, from revenue, expenses, other resources and other obligations. Therefore ownership contributions and ownership distributions are defined as elements. Detailed guidance to support the assessment of whether certain inflows and outflows of resources satisfy the definitions of ownership contributions and ownership distributions can be developed at standards level as appropriate.
### Recognition

**Staff comment:** In accordance with directions at the March 2014 meeting the section on Recognition in Chapter 5 has been relocated to a new chapter. The revision reflects the staff proposals at the March 2014 meeting. The term “Existence Uncertainty” has been replaced with “Uncertainty-Existence of an Element”. This is also reflected in the sub-headings. Paragraphs 7.1-7.4 reflect the staff drafting proposals accepted at the March 2014 meeting. Additional material has been added to paragraph 1.6 to indicate that disclosures can provide useful information about estimation techniques and to acknowledge that there may be rare instances where level of uncertainty in an estimate is so large that the relevance and faithful representativeness of the estimated information is questionable even with disclosures.

#### Recognition Criteria and their Relationship to Disclosure

1. Recognition is the process of incorporating in the appropriate financial statement an item that meets the definition of an element and can be measured in a way that meets the QCs and constraints on information included in the QCs. All items that satisfy the definition of an element and the recognition criteria are recognized in the financial statements. In some circumstances, an IPSAS may also specify that, to achieve the objectives of financial reporting, a resource or obligation that does not meet the definition of an element is to be recognized in the financial statements provided it can be measured in a way that meets the QCs and constraints. Other resources and other obligations are discussed in Chapter 5. Recognition is a distinct stage in the accounting process. Therefore the definitions of the elements do not include recognition criteria. Recognition involves an assessment of existence uncertainty and measurement uncertainty. The conditions that give rise to uncertainty can change. Therefore it is important that uncertainty is assessed at each reporting date.

2. Recognition involves an assessment of uncertainty related to the existence and measurement of the element or other resource or other obligation. The conditions that give rise to uncertainty can change. Therefore it is important that uncertainty is assessed at each reporting date. While recognition is viewed as a distinct stage in the accounting process, matters relevant to an assessment of uncertainty over the existence of an element will have been considered in determining whether the item satisfies the definition of an element.

#### Existence Uncertainty: Existence of an Element

1. Uncertainty about the existence of an element is addressed by assessing the available evidence in order to make a neutral judgment about whether an item satisfies all essential characteristics of the definition of that element, taking into account all available facts and circumstances at the reporting date. If the definition is not satisfied, an element does not exist and, as such, the item would not qualify for recognition as an element. However, as noted in paragraph 5.2 above Chapter 5, *Elements in Financial Statements*, consistent with the requirements or guidance in an IPSAS, the item may be recognized as an "other economic phenomenon" (other resource or other obligation). Determining whether the definition of an element has been satisfied requires judgment. Although the occurrence of a transaction is not necessary in order for an element to exist, transactions are the most common basis for recognizing and derecognizing items as elements. For example, the acquisition of medical equipment normally provides sufficient information to justify the recognition of an asset; similarly an employee providing services in accordance with a contract of
employment gives rise to a liability and an expense of the employer. In other cases, it may be more difficult to determine whether an event creates an item that meets the definition of an element, because entities operate in uncertain environments.

7.1 If it is determined that an element exists, uncertainty about the flows of service potential or economic benefits related to that element are taken into account in the measurement of that element. Where an IPSAS specifies that a resource or obligation other than an element is to be recognized, uncertainty about the flows of service potential or economic benefits related to that resource or obligation is similarly taken into account in its measurement. Preparers should review and assess all available evidence in determining whether sufficient evidence exists that an element should be recognized initially, whether that element continues to qualify for recognition (see paragraph 17.87), or whether there has been a change to an existing element.

7.2 Uncertainty is addressed by assessing the available evidence in order to make a neutral judgment about whether an element exists, taking into account all available facts and circumstances at the reporting date. If it is determined that an element exists, uncertainty about the flows of service potential or economic benefits related to that element are taken into account in the measurement of that element. Preparers should review and assess all available evidence in determining whether sufficient evidence exists that an element should be recognized initially, whether that element continues to qualify for recognition (see paragraph 7.7), or whether there has been a change to an existing element.

**Measurement Uncertainty**

7.3 In order to recognize an item in the financial statements, it is necessary to attach a monetary value to the item. This entails choosing an appropriate measurement basis and determining whether the measurement of the item satisfies the QCs, including that the measurement is sufficiently relevant and faithfully representative for the item to be recognized in the financial statements. The selection of an appropriate measurement basis is considered in Chapter 76, Measurement of Assets and Liabilities in Financial Statements.

1.6 There may be uncertainty associated with the measurement of many amounts presented in the financial statements. The use of estimates is an essential part of the accrual basis of accounting. A decision about the relevance and faithful representativeness of measurement involves the consideration of techniques, such as using ranges of outcomes and point estimates; and whether additional evidence is available about economic circumstances that existed at the reporting date. Disclosures can provide useful information on estimation techniques. There may be rare instances in which the level of uncertainty in an estimate is so large that the relevance and faithful representativeness of the estimated information is questionable even if disclosures are provided to explain estimation techniques.

7.4 **Disclosure and Recognition**

7.5 The failure to recognize items that meet the definition of an element and the recognition criteria is not rectified by the disclosure of accounting policies, notes or other explanatory detail. However disclosure can provide information on items that meet many, but not all the essential characteristics of the definition of an element.Disclosure can also provide information on items that meet the definition of an element but cannot be measured in a manner that is sufficiently representationally faithful to meet the objectives of financial reporting. Disclosure is appropriate when
knowledge of the item is considered to be relevant to the evaluation of the net financial position of the entity and therefore meets the objectives of financial reporting.

**Derecognition**

7.6 Derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrant removing an item that has been previously recognized from the financial statements. In evaluating existence uncertainty the same criteria are used for derecognition as at initial recognition.
Recognition

Staff Comment: Marked-up changes are those to the section of the Basis for Conclusions in Chapter 5 in the March 2014 version.

Recognition and its Relationship to the Definition of the Elements

BC1. The IPSASB considered whether all recognition criteria should be integrated in definitions of the elements. The IPSASB acknowledged the view that the inclusion of recognition criteria in definitions of the elements enables preparers to consider all the factors that must be taken into account in evaluating whether an item of information is recognized as an element in the financial statements. However, the IPSASB took the view that while there is overlap in factors to be considered in determining whether an item satisfies the definition of an element and whether that element qualifies for recognition, particularly in respect of whether the recognition criterion of existence uncertainty is met, recognition should be considered as a distinct stage in the financial reporting process. This is because recognition embraces consideration of factors broader than whether the definition of an element is satisfied and may apply to the recognition of items that do not satisfy the definition of an element. The IPSASB also noted that few respondents to CF–CP2 and CF–ED2 supported the integration of recognition criteria in element definitions. After considering this feedback, the IPSASB concluded that element definitions should not include recognition criteria.

BC2. In determining whether an element should be recognized there are two types of uncertainty that need to be considered. The first is uncertainty over the existence of an element–matters that will have been considered in determining whether an item meets the definition of an element? The second is to consider measurement uncertainty–whether the element can be measured in a representationally faithful manner? The second aspect is only considered if it is determined that the definition of an element has been met.

Uncertainty: Existence of an Element

BC3. The IPSASB considered whether, in dealing with existence uncertainty over the existence of an element, (a) standardized threshold criteria should be adopted, or (b) whether all available evidence should be used to make neutral judgements about an element's existence.

BC4. Standardized evidence thresholds filter items that have a low probability of resulting in an inflow or outflow of service potential or economic benefits. Such items may have high monetary values and therefore lead to the recognition of elements with significant amounts, even though the probability of existence may be low. Some consider that it would be more appropriate to disclose such items rather than recognize them. Threshold criteria are also justified on cost grounds, because only after a preparer has formed an initial judgement whether those threshold criteria have been met does the preparer consider how that element should be measured.

BC5. The IPSASB formed a view that the adoption of thresholds for recognition purposes risks omitting information that is relevant and faithfully representative and may not meet the QC of comparability, because similar information items may be treated in different ways dependent upon relatively small differences in the probability of a flow of benefits. The IPSASB acknowledges that such risks can also exist for approaches which do not specify thresholds for recognition. This is because preparers will make their own assessments of the circumstances or "the threshold" that justifies recognition and those assessments can change for different items and over time. However, the IPSASB concluded
that, on balance, an approach that is based on an assessment of all available evidence in determining whether an element exists and takes account of uncertainty about the flows of service potential or economic benefits in measurement is a more appropriate response to the uncertainty faced by preparers of financial statements. It is more likely to result in the recognition of information that satisfies the QCs than is the establishment of an arbitrary threshold that must be adhered to. Guidance may be provided at standards level on dealing with circumstances in which there is significant uncertainty about whether an element exists in particular circumstances, and therefore whether it would satisfy the criteria for recognition.

BC6. The IPSASB explored whether existence uncertainty about the existence of an element is specific to certain components of assets and liabilities, in particular for assets whether an entity controls a resource or a right to a resource and for liabilities whether an entity has little or no realistic alternative to avoid an outflow of service potential or economic benefits. The rationale for this approach is that these are the essential characteristics of an asset and a liability where existence uncertainty is likely to arise.

BC7. The IPSASB took the view that, in the context of assets and liabilities, existence uncertainty relates to more than just these characteristics. Existence uncertainty might also relate to the existence of a present obligation and a past event for liabilities and, in particular, whether a resource that generates future economic benefits or service potential presently exists rather than a future resource or future right to a resource in the context of an asset. As noted in paragraph BC260 these matters will also have been considered in determining whether an item satisfies the definition of an element.

BC8. The IPSASB also took the view that existence uncertainty is not restricted to just assets and liabilities. While changes in other elements are normally accompanied by changes in assets and liabilities, this may not always be the case. The IPSASB therefore rejected an approach whereby discussion of existence uncertainty about existence is restricted to assets and liabilities.

**Measurement Uncertainty**

BC9. A range of estimates and measurement techniques may be used to deal with uncertainty associated with the measurement of items that might be presented in the financial statements. In most cases, the application of these measurement and estimation techniques, and the consideration of other relevant information about economic circumstances that exist at reporting date, will result in a measurement that satisfies the QCs. However, in rare circumstances, such as in some legal disputes, it may be that no measure of an asset or a liability would result in a sufficiently faithful representation of that element for it to warrant recognition.

**Derecognition**

BC10. The IPSASB considered the view that different criteria should be used for initial recognition and derecognition. The IPSASB concluded that adopting differential recognition criteria would conflict with the QC of consistency as it would lead to the recognition of items with different standards of evidence for their existence. Many of the respondents to CF–CP2 and CF–ED2 also supported the use of the same criteria for derecognition as for initial recognition.
1. **Recognition**

   **Staff comment:** In accordance with directions at the March 2014 meeting the section on Recognition in Chapter 5 has been relocated to a new chapter. The revision reflects the staff proposals at the March 2014 meeting. The term “Existence Uncertainty” has been replaced with “Uncertainty: Existence of an Element”. This is also reflected in the sub-headings. Paragraphs 7.1-7.4 reflect the staff drafting proposals accepted at the March 2014 meeting.

   Additional material has been added to paragraph 1.6 to indicate that disclosures can provide useful information about estimation techniques and to acknowledge that there may be rare instances where level of uncertainty in an estimate is so large that the relevance and faithful representativeness of the estimated information is questionable even with disclosures.

**Recognition Criteria and their Relationship to Disclosure**

1.1 Recognition is the process of incorporating in the appropriate financial statement an item that meets the definition of an element and can be measured in a way that meets the QCs and constraints on information included in the QCs. All items that satisfy the definition of an element and the recognition criteria are recognized in the financial statements. In some circumstances, an IPSAS may also specify that, to achieve the objectives of financial reporting, a resource or obligation that does not meet the definition of an element is to be recognized in the financial statements provided it can be measured in a way that meets the QCs and constraints. Other resources and other obligations are discussed in Chapter 5.

1.2 Recognition involves an assessment of uncertainty related to the existence and measurement of the element or other resource or other obligation. The conditions that give rise to uncertainty can change. Therefore it is important that uncertainty is assessed at each reporting date. While recognition is viewed as a distinct stage in the accounting process, matters relevant to an assessment of uncertainty over the existence of an element will have been considered in determining whether the item satisfies the definition of an element.

**Uncertainty: Existence of an Element**

1.3 Uncertainty about the existence of an element is addressed by assessing the available evidence in order to make a neutral judgment about whether an item satisfies all essential characteristics of the definition of that element, taking into account all available facts and circumstances at the reporting date. If the definition is not satisfied, an element does not exist and, as such, the item would not qualify for recognition as an element. However, as noted in Chapter 5, *Elements in Financial Statements*, consistent with the requirements or guidance in an IPSAS, the item may be recognized as an "other economic phenomenon" (other resource or other obligation).

1.4 If it is determined that an element exists, uncertainty about the flows of service potential or economic benefits related to that element are taken into account in the measurement of that element. Where an IPSAS specifies that a resource or obligation other than an element is to be recognized, uncertainty about the flows of service potential or economic benefits related to that resource or obligation is similarly taken into account in its measurement. Preparers should review and assess all available evidence in determining whether sufficient evidence exists that an element should be
recognized initially, whether that element continues to qualify for recognition (see paragraph 1.8), or whether there has been a change to an existing element.

Measurement Uncertainty

1.5 In order to recognize an item in the financial statements, it is necessary to attach a monetary value to the item. This entails choosing an appropriate measurement basis and determining whether the measurement of the item satisfies the QCs, including that the measurement is sufficiently relevant and faithfully representative for the item to be recognized in the financial statements. The selection of an appropriate measurement basis is considered in Chapter 7, Measurement of Assets and Liabilities in Financial Statements.

1.6 There may be uncertainty associated with the measurement of many amounts presented in the financial statements. The use of estimates is an essential part of the accrual basis of accounting. A decision about the relevance and faithful representativeness of measurement involves the consideration of techniques, such as using ranges of outcomes and point estimates; and whether additional evidence is available about economic circumstances that existed at the reporting date. Disclosures can provide useful information on estimation techniques. There may be rare instances in which the level of uncertainty in an estimate is so large that the relevance and faithful representativeness of the estimated information is questionable even if disclosures are provided to explain estimation techniques.

Disclosure and Recognition

1.7 The failure to recognize items that meet the definition of an element and the recognition criteria is not rectified by the disclosure of accounting policies, notes or other explanatory detail. However disclosure can provide information on items that meet many, but not all the essential characteristics of the definition of an element. Disclosure can also provide information on items that meet the definition of an element but cannot be measured in a manner that is sufficiently representationally faithful to meet the objectives of financial reporting. Disclosure is appropriate when knowledge of the item is considered to be relevant to the evaluation of the net financial position of the entity and therefore meets the objectives of financial reporting.

Derecognition

1.8 Derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrant removing an item that has been previously recognized from the financial statements. In evaluating existence uncertainty the same criteria are used for derecognition as at initial recognition.
Recognition

Staff Comment: Marked-up changes are those to the section of the Basis for Conclusions in Chapter 5 in the March 2014 version.

Recognition and its Relationship to the Definition of the Elements

BC1. The IPSASB considered whether all recognition criteria should be integrated in definitions of the elements. The IPSASB acknowledged the view that the inclusion of recognition criteria in definitions of the elements enables preparers to consider all the factors that must be taken into account in evaluating whether an item of information is recognized as an element in the financial statements. However, the IPSASB took the view that while there is overlap in factors to be considered in determining whether an item satisfies the definition of an element and whether that element qualifies for recognition, particularly in respect of whether the recognition criterion of existence uncertainty is met, recognition should be considered as a distinct stage in the financial reporting process. This is because recognition embraces consideration of factors broader than whether the definition of an element is satisfied and may apply to the recognition of items that do not satisfy the definition of an element. The IPSASB also noted that few respondents to CF–CP2 and CF–ED2 supported the integration of recognition criteria in element definitions. After considering this feedback, the IPSASB concluded that element definitions should not include recognition criteria.

BC2. In determining whether an element should be recognized there are two types of uncertainty that need to be considered. The first is uncertainty over the existence of an element—matters that will have been considered in determining whether an item meets the definition of an element? The second is to consider measurement uncertainty—whether the element can be measured in a representationally faithful manner? The second aspect is only considered if it is determined that the definition of an element has been met.

Uncertainty: Existence of an Element

BC3. The IPSASB considered whether, in dealing with e uncertainty over the existence of an element, (a) standardized threshold criteria should be adopted, or (b) whether all available evidence should be used to make neutral judgements about an element’s existence.

BC4. Standardized evidence thresholds filter items that have a low probability of resulting in an inflow or outflow of service potential or economic benefits. Such items may have high monetary values and therefore lead to the recognition of elements with significant amounts, even though the probability of existence may be low. Some consider that it would be more appropriate to disclose such items rather than recognize them. Threshold criteria are also justified on cost grounds, because only after a preparer has formed an initial judgement whether those threshold criteria have been met does the preparer consider how that element should be measured.

BC5. The IPSASB formed a view that the adoption of thresholds for recognition purposes risks omitting information that is relevant and faithfully representative and may not meet the QC of comparability, because similar information items may be treated in different ways dependent upon relatively small differences in the probability of a flow of benefits. The IPSASB acknowledges that such risks can also exist for approaches which do not specify thresholds for recognition. This is because preparers will make their own assessments of the circumstances or "the threshold" that justifies recognition and those assessments can change for different items and over time. However, the IPSASB
concluded that, on balance, an approach that is based on an assessment of all available evidence in determining whether an element exists and takes account of uncertainty about the flows of service potential or economic benefits in measurement is a more appropriate response to the uncertainty faced by preparers of financial statements. It is more likely to result in the recognition of information that satisfies the QCs than is the establishment of an arbitrary threshold that must be adhered to. Guidance may be provided at standards level on dealing with circumstances in which there is significant uncertainty about whether an element exists in particular circumstances, and therefore whether it would satisfy the criteria for recognition.

BC6. The IPSASB explored whether uncertainty about the existence of an element is specific to certain components of assets and liabilities, in particular for assets whether an entity controls a resource or a right to a resource and for liabilities whether an entity has little or no realistic alternative to avoid an outflow of service potential or economic benefits. The rationale for this approach is that these are the essential characteristics of an asset and a liability where uncertainty is likely to arise.

BC7. The IPSASB took the view that, in the context of assets and liabilities, uncertainty relates to more than just these characteristics. There might also be uncertainty about the existence of a present obligation and a past event for liabilities and, in particular, whether a resource that generates future economic benefits or service potential presently exists rather than a future resource or future right to a resource in the context of an asset. As noted in paragraph BC2 these matters will also have been considered in determining whether an item satisfies the definition of an element.

BC8. The IPSASB also took the view that uncertainty is not restricted to just assets and liabilities. While changes in other elements are normally accompanied by changes in assets and liabilities, this may not always be the case. The IPSASB therefore rejected an approach whereby discussion of existence is restricted to assets and liabilities.

Measurement Uncertainty

BC9. A range of estimates and measurement techniques may be used to deal with uncertainty associated with the measurement of items that might be presented in the financial statements. In most cases, the application of these measurement and estimation techniques, and the consideration of other relevant information about economic circumstances that exist at reporting date, will result in a measurement that satisfies the QCs. However, in rare circumstances, such as in some legal disputes, it may be that no measure of an asset or a liability would result in a sufficiently faithful representation of that element for it to warrant recognition.

Dererecognition

BC10. The IPSASB considered the view that different criteria should be used for initial recognition and derecognition. The IPSASB concluded that adopting differential recognition criteria would conflict with the QC of consistency as it would lead to the recognition of items with different standards of evidence for their existence. Many of the respondents to CF–CP2 and CF–ED2 also supported the use of the same criteria for derecognition as for initial recognition.
DRAFT MINUTES OF MARCH 2014 MEETING: CONCEPTUAL FRAMEWORK: ELEMENTS AND RECOGNITION IN FINANCIAL STATEMENTS

Staff presented an Issues Paper that provided background on the IPSASB’s development of its approaches to the issue of deferred flows and considered issues related to the development of Option D: Other Economic Phenomena not Meeting the Definition of an Element; following the tentative decision to adopt this option at the December 2014 meeting:

Development of approaches to deferred inflows and deferred outflows

The Coordinator summarized the development of the IPSASB’s approach to deferred inflows (DIs) and deferred outflows (DOs). The summary started with the discussion of the asset and liability-led (A & L-led) and revenue and expense-led (R & E-led) approaches in the 2010 Consultation Paper, Elements and Recognition in Financial Statements (CF–CP2). CF–CP2 had identified options for dealing with deferred flows, including the development of separate elements. He noted that although a small majority of respondents expressing a view had favored the A & L-led approach the response had been inconclusive and in places inconsistent.

The Coordinator then highlighted the development of the approach in the 2012 Exposure Draft, Elements and Recognition in Financial Statements (CF–ED2), which had proposed DIs and DOs as elements restricted to non-exchange transactions with specific time stipulations. He stated that the majority of the respondents to CF–ED2 disagreed with defining DIs and DOs as elements and that under a third of respondents had supported these elements. However, a number of respondents had expressed a view that information on flows relating to particular reporting periods has value. The Coordinator also pointed out that a number of respondents had challenged the restrictions in the proposed definitions to non-exchange transactions and specified time periods as conceptually weak.

The summary concluded with the discussions and decisions at the September 2013 and December 2013 meetings, culminating in the tentative decision not to define DIs and DOs as elements, but to accept that certain economic phenomena that do not meet the definition of an element may need to be recognized in the financial statements in order to meet the objectives of financial reporting.

Members agreed that the summary largely captured the main points. A member emphasized that the reason that the proposed definitions of DIs and DOs were restricted to non-exchange transactions was that the definitions of an asset and a liability adequately covered exchange transactions. Another member considered that the summary gave a clearer account of the IPSASB’s deliberations than the current Basis for Conclusions (BC) and suggested that some of the material should be included in the BC.

The IPSASB then considered the following issues:

- Terminology
- Definitions of an asset and a liability, net assets and net financial position
- Capital maintenance
- Financial performance
- Definitions of revenue and expense
- Recognition of other resources and other obligations
State of development of conceptual thinking

Terminology

Staff noted a view that had arisen in a meeting with the Australian Accounting Standards Board that the term ‘other economic phenomena’ might be confused with the term ‘other comprehensive income’ used in the International Accounting Standards Board’s literature. The Coordinator also said that use of the term other economic phenomena had created difficulties in revising the definitions of revenue and expense. The Coordinator said that staff favored the terms ‘other resources’ and ‘other obligations’

The Chair said that he did not favor changing terms because of the discussions at one meeting. A view was also expressed that there can often be confusion with a new term when it is first introduced and that the terms other resources and other obligations can be confused with the words ‘resources’ and ‘obligations’ in the definitions of an asset and a liability.

Other members, including Phase 2 Task Based Group (TBG) members, considered that other resources and other obligations are more appropriate terms. There was some concern about how the term other economic phenomena might be interpreted and that because the term refers to both debits and credits it might be confusing.

Following a proposal from a TBG member the IPSASB directed that other economic phenomena is an overarching term that will be used in section 1 of the Elements chapter. The terms other resources and other obligations will be used subsequently in the chapter.

Definitions of an asset and a liability, net assets and net financial position

The IPSASB confirmed the staff and TBG proposal that the definitions of an asset and a liability should be those agreed at the December 2013 meeting:

- An asset is a resource that an entity presently controls as a result of a past event; and
- A liability is a present obligation of an entity for an outflow of resources that results from a past event.

The TBG explained that the impact of other resources and other obligations meant that net assets would not always be the residual position of the reporting entity. The TBG favored describing net financial position as a measure that is the aggregate of net assets, other resources and other obligations. One of the main issues was how net assets should be reflected in the chapter. The TBG was particularly keen to get a view from other members on this issue.

A number of members expressed reservations about a ‘double bottom line’ with discussion of both net assets and net financial position. According to this view the Framework only need to describe net financial position. Others considered that the notion of two bottom lines was primarily presentational.

Reservations were expressed that while net assets is a generally understood term, net financial position is a new term and should be defined. However, some questioned whether net assets is well understood and whether its conceptual meaning is clear.

One member did not support the term net financial position, because the term ‘past event’ is not defined in the Framework. This member considered that past event is a key term and that a formal definition should be developed and included in the Glossary of Terms. Staff highlighted that past event is described in the context of an asset and a liability in paragraphs 2.8 and 3.4 and also that the term ‘obligating event’ is defined at standards level.
Some concern was also expressed that the term net financial position is close to, and could be confused with, the term net worth in Government Finance Statistics. It was noted that many terms in accounting are close to terms in other areas such as economic and statistics.

The IPSASB directed that the Framework will describe net financial position, but will not provide a detailed explanation because the interpretation of net financial position will be determined by reference to the nature of the other resources and other obligations recognized in the financial statements. The chapter will not refer to net assets.

**Capital maintenance**

The Coordinator requested that the IPSASB decide what, if anything, the chapter on elements and recognition should say about concepts of capital maintenance. He noted that there had been some consideration of capital maintenance in Phase 3: Measurement, but that capital maintenance had not been discussed either in the Phase 3 Consultation Paper or Exposure Draft. The Coordinator summarized briefly the financial capital maintenance and physical capital maintenance models and expressed a view that the latter could probably be adapted to the public sector reflecting the service delivery objective of most public sector entities. However, this would require considerable extra work.

A TBG member expressed a view that the notion of surplus is important in the public sector and that he was not satisfied that the IPSASB has adequately defined it. He considered that the IPSASB should signal that further work needs to be done on capital maintenance in order to better define surplus and deficit. A further view was that there needs to be consideration of whether nominal or real capital maintenance is most appropriate in the public sector.

Staff was directed to include some discussion of capital maintenance in the BC with an explanation that the concepts of capital maintenance are not well developed for the public sector and that it had been decided not to include them in the Framework.

**Financial Performance**

The Coordinator noted that the two main models of financial performance that had been considered during this phase of the project’s development were:

- Changes in net assets during the period; and
- Flows relating to the period

The TBG had considered both these models important and had developed paragraphs 4.7-4.9, which discussed financial performance in the context of an entity’s operational and funding model.

Members expressed reservations about the inclusion of paragraphs 4.8 and 4.9 because operational and funding models in the public sector are underdeveloped and the relevance of the business model approach in the public sector had been only recently explored. It was also noted that these paragraphs had not been exposed in CF–ED2. It was therefore agreed that there would simply be a statement that "all items that met the definition of revenue and expenses and the recognition criteria set out in the chapter on recognition are reported on the statement of financial performance. The difference between revenue and expenses is the entity’s surplus or deficit for the period."

It was agreed that the Basis for Conclusions should include a summary of paragraphs 4.8 and 4.9 and the reason why they were not included in the core text in order to indicate the IPSASB’s consideration of financial performance.
Definitions of revenue and expense

The Coordinator said that the TBG had considered two approaches to revising the definitions of revenue and expense following the decision not to define deferred inflows and deferred outflows as elements:

(a) Define revenue and expense by reference to movements in net financial position; or
(b) Define revenue and expense by reference to movements in net assets with an acknowledgement that definitions of revenue and expense neither preclude nor require other items to be reported in surplus or deficit.

The TBG considered that the first approach is more transparent. Staff had subsequently developed definitions in accordance with approach (a):

- Revenue is:
  (i) Increases in assets and other resources and reductions in liabilities during the current reporting period that increase the net financial position, other than ownership contributions; and
  (ii) Reductions in amounts recognized as other obligations in previous reporting periods.

- Expense is:
  (i) Increases in liabilities and other obligations and reductions in assets during the current reporting period that decrease the net financial position, other than ownership distributions; and
  (ii) Reductions in amounts recognized as other resources in previous reporting periods.

Although there was some support for approach (b), most members supported the TBG’s view that revenue and expense should be defined by reference to movements in net financial position. However, there were views that the definitions could be simplified by referring directly to net financial position, while describing inflows and outflows in supporting narrative. Staff was directed to develop revised definitions of revenue and expense.

Recognition of other resources and other obligations

The IPSASB agreed with the staff view that consideration of measurement uncertainty is relevant for other resources and other obligations.

State of development of conceptual thinking

The IPSASB acknowledged that while the IPSASB’s approach is clearly determined in most areas of the Framework the approach to certain aspects of the elements is open to further development. However, the IPSASB did not support usage of the term ‘living document’ and wanted to ensure that it did not communicate a misleading message that the Framework is an intermediate step. The Basis for Conclusion will include an acknowledgment that in a few areas concepts are still developing and note that, as a consequence, the elements may be developed further in the future.

Page-by-page review of main text

The IPSASB carried out a page-by-page review of the draft chapters. The principal directions were that:
- The introductory discussion of other economic phenomena and other resources and obligations in paragraph 1.4 is balanced and clear and should be retained;
- In accordance with the prior discussion on net assets the description of net assets and accompanying formula in paragraph 1.6 and the references to net assets on paragraph 1.8 would be deleted;
- The formulaic description of net financial position in paragraph 1.7 should be retained;
- The word ‘presently’ in the context of control in the definition of an asset should be retained;
- The sentence in paragraph 2.7 suggesting that an inability to deny access of certain external parties to a resource leads to a questioning of the existence of control would be deleted;
- While the decision not to define a past event was confirmed the point that it is essential to determine the point or event at which rights and powers give rise to an asset of the entity would in paragraph 2.8 would be brought forward in order to give it more emphasis;
- Staff review usage of the word ‘assets’ in section 2 and consider whether ‘resources’ would be more appropriate in some instances;
- In the context of a present obligation in the definition of a liability the term “non-legally binding obligation” should be used rather than “other binding obligation” and the BC should note that ‘non-legally binding’ does not mean illegal;
- In section 4 paragraphs 4.3, 4.5, and 4.6 would be deleted, as would paragraphs 4.8 and 4.9 in accordance with previous decisions;
- In paragraph 5.2 the reference to ‘presented’ in the context of a resource or obligation that does not satisfy the definition of an element should be changed to ‘recognized’; and
- In paragraph 6.2 the reference to ‘ownership contributions and ownership distributions being reported in other financial statements’ will be deleted.

Recognition

Staff acknowledged that the IPSASB had spent a considerable amount of meeting time discussing the section on Recognition and, in particular, had confirmed that existence uncertainty related to all aspects of the definition of an asset and a liability, rather than the flows of resources. However, staff considered that the current approach was flawed, primarily because of the statement in paragraph 7.1 that recognition is a distinct phase in the accounting process. Staff expressed a view that, as described, existence uncertainty would have been considered in determining whether the definition of an element had been satisfied and that it was difficult to sustain an assertion that the analysis of existence uncertainty is a distinct phase. Staff also proposed that existence uncertainty be restated ‘Uncertainty-existence of an element.’

There was a broad acceptance of the staff view that the reference to recognition as a distinct phase in the accounting process should be removed. There was some initial support for moving discussion over the existence of an element to the sections of the chapter on an asset and a liability. The Chair noted that there was little or no comment from respondents in favor of breaking up the section and relocating part of it. Other members also did not favor separating the steps in the recognition process. However, it was agreed that the section on recognition will be converted into a separate chapter with sub-sections on uncertainty of the existence of an element, measurement uncertainty and derecognition.

Page-by-page review of Basis for Conclusions

The IPSASB continued its page-by-page review by considering the C. The principal directions were that:
The word ‘activities’ in the discussion of the proposals in CF–ED2 should be explained more clearly or replaced;

The term ‘inflow of resources’ in the context of the discussion of the IPSASB’s deliberations on a resource in paragraph BC5 should be altered to state that ‘a resource embodies service potential’;

The need for sub-titles for ‘unconditional rights’ and ‘executory contracts’ was questioned. Staff expressed a view that the sub-titles made the readability of the BC better. It was also directed that more generally the BC needs to include a well-argued rationale why items that are not in the core text of the Framework are discussed in the BC and why certain items have been devolved to the standards level rather than being addressed in the Framework;

The relationship between a conditional obligation and a stand-ready obligation in paragraphs BC23-BC27 should be clarified;

In accordance with a prior decision the reference to ‘a living document’ in paragraph BC43 should be deleted and the discussion modified;

The reference to a distrust of recycling as the reason for not identifying DIs and DOs as elements of the statement of financial performance was misleading as recycling might still occur with other resources and other obligations. It should therefore be deleted;

The last sentence of paragraph BC55 on the presentation of information about period flows was circular and should be revised; and

The Alternative Views would not be included in the final chapter

**Structure**

The IPSASB discussed the structure of the chapter. In particular it was agreed that, because the definitions of revenue and expense were reliant on the descriptions of other resources, other obligations and net financial position. The section on other resources, other obligations and net financial position should precede the section of revenue and expense. The IPSASB directed that the sections of the chapter will be restructured in the sequence:

- Introduction
- Assets
- Liabilities
- Other Resources and Other Obligations and Net Financial Position
- Revenue and Expense
- Ownership Contributions and Ownership Distributions

The IPSASB agreed to review a further version of the draft final chapter at the June 2014 meeting.