ATTACHMENT A

HoTARAC RESPONSE TO IPSASB CONSULTATION PAPER ‘CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES: ELEMENTS AND RECOGNITION IN FINANCIAL STATEMENTS’

General comments

HoTARAC notes the IPSASB’s comment on page 4 of the Consultation Paper that “the purpose of the IPSASB’s project is not to interpret the application of the IASB Framework to the public sector”. However, no reasons have been given as to why the International Accounting Standards Board’s (IASB) conceptual framework is so fundamentally unsuitable for public sector entities, that development of a separate conceptual framework for such entities is warranted. HoTARAC believes the IPSASB’s “Process for Reviewing and Modifying IASB Documents” is applicable (at least in part) to the development of a conceptual framework – particularly if alignment (to the degree possible) with IFRS is to remain an objective.

HoTARAC’s preference is that the IPSASB and IASB work more closely to achieve convergence of their respective conceptual frameworks and other pronouncements. Even if this would delay progress from an IPSASB perspective, HoTARAC believes such convergence would result in superior long-term outcomes for public sector entities globally. The greater the potential for divergence between pronouncements applicable to government business enterprises (GBEs) (issued by the IASB) and pronouncements applicable to other public sector entities (potentially issued by the IPSASB), the more significant are the practical difficulties in preparing consolidated financial statements for a whole-of-Government reporting entity. HoTARAC recommends that the IPSASB communicate to constituents how and when it will address this obvious tension between standard-setter frameworks under which various public sector entities might operate.

On page 4 of the Consultation Paper, the IPSASB states it is considering the potential for convergence with the concepts underlying statistical financial reporting models in developing the Conceptual Framework. HoTARAC prefers that the focus instead be on the underlying conceptual merits for general purpose financial statements. However, should the IPSASB identify more than one approach as being suitable, HoTARAC would support selection of that basis that most closely aligns with the GFS statistical model.

HoTARAC notes that the IPSASB’s Conceptual Framework project is stated as applicable to general purpose financial reporting (which is a wider concept than general purpose financial statements). However, the IPSASB’s Consultation Papers for Phases 2 and 3 of this project appear to more directly relate to general purpose financial statements.

Further, in light of the IPSASB’s arrangements for release of separate documents for each phase of its Conceptual Framework project, HoTARAC would prefer more clarity about how the finalised Conceptual Framework documentation will be issued e.g. will it be issued as –

- one inter-connected document with self-contained chapters for particular matters (e.g. elements and recognition, measurement etc);
- one document setting out the over-arching principles – which HoTARAC presumes relates to Phase 1 - with separate documents that deal with specific aspects (e.g. elements and recognition, measurement etc) but which are all subject to the over-arching principles; or
- some other arrangement.

Since some Conceptual Framework concepts (like measurement) could be applied beyond the boundaries of general purpose financial statements, HoTARAC recommends that the IPSASB clarify the application of all phases (particularly phase 1) of its Conceptual Framework.

HoTARAC strongly recommends that the IPSASB's Conceptual Framework (as the term implies) be restricted to high-level principles that are appropriate to reporting by the broad range of public sector entities. HoTARAC believes that issues relating to the practical application of those high-level principles only be dealt with in IPSASs.

HoTARAC also recommends that the IPSASB clearly communicate to constituents how and when the eventual outcomes of the IPSASB's conceptual framework project will be reflected in existing IPSASs, to ensure consistency across all IPSASB pronouncements.

Specific Matter for Comment 1

(a) Should the definition of an asset cover all of the following types of benefits—those in the form of:
- *(i) Service potential;*
- *(ii) Net cash inflows; and*
- *(iii) Unconditional rights to receive resources?*

(b) What term should be used in the definition of an asset:
- *(i) Economic benefits and service potential; or*
- *(ii) Economic benefits?*

(a) HoTARAC believes an asset should be defined in terms of "economic benefits", which would encompass all of the three types of benefits.

(b) HoTARAC considers that the concept of service potential is critical to the public sector and should be included in the Framework.

HoTARAC believes that whether 'service potential' is incorporated into the definition separately, or as a subset of economic benefits, is only a matter of terminology. As long as the definitions are clear, it is not an issue of significant importance in our view.

HoTARAC supports an asset being defined in terms of 'economic benefits', provided that the concept of economic benefits include the notion of service potential, net cash inflows, and unconditional rights to receive resources.

Specifically including the concepts of service potential and the resource being useful to achieve an entity's objective(s) are important as they capture situations specific to the public sector and provide relevant information in the public sector context.

Accordingly, HoTARAC suggests that the definition for an asset be framed as follows:

> "assets are resources that provide future economic benefits that are useful to achieve the entity's objective(s)".

In relation to the terminology for the definition of an asset, HoTARAC supports the view that 'service potential' can be viewed as an economic benefit to a public sector entity and therefore can be included as a subset of economic benefits. There are two arguments to support this view. Firstly, "service potential" is by definition something of value to an entity, which as noted in paragraph 2.12, is also the definitional characteristic of an "economic resource". Secondly, acquisition of "service potential" will often require the sacrifice of other economic resources. Therefore, access to service potential is an economic benefit as it reduces the need for an entity to forego economic resources.

What is considered more important is clarity around the definition of "service potential" as there are several contradictory notions within the document of service potential and its relationship with cash flows. A single definition of service potential that either clearly includes or excludes cash flows would be helpful. This will also in turn influence whether the definition substance of an asset needs to specifically identify net cash inflows as a separate component.

Other comments:

HoTARAC notes the text limits conditional rights to those arising from contracts/binding agreements and some discussion of constructive obligation and non-exchange transactions (including international treaties such as Kyoto and tax receivable) would be useful as this is an overarching definition of an asset in a public sector context. HoTARAC also recommends the discussion on offsetting 'unconditional promises' consider the rights and obligations arising from a party's performance obligations under an agreement as currently being considered under the IASB's revenue recognition project. This project focuses on the obligation rather than whether the entity has been paid for the unconditional promise.

Specific Matter for Comment 2

(a) *Which approach do you believe should be used to associate an asset with a specific entity:*
   (i) Control;
   (ii) Risks and rewards; or
   (iii) Access to rights, including the right to restrict or deny others' access to rights?

(b) *Does an entity's enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others' access link a resource to a specific entity?*

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

(a) HoTARAC is of the view that control should be the primary criterion used to associate an asset with a specific entity. In addition, HoTARAC is of the view that the following are critical factors that indicate the existence of control:
   - risks and rewards;
   - the ability to restrict or deny access of others' to benefits; and/or
   - enforceable claim to benefits.

   As per HoTARAC's previous comment in the response to ED 194 *Service Concession Arrangements*, the concept of risks and rewards is complementary to, and indicative of, control, and the concepts are not mutually exclusive. The concept of risks and rewards could be considered to be a more sophisticated aspect of control, however it is also more complex to apply in practice as a result. As highlighted in the consultation paper, different parties may have rights to different benefits and risk exposures related to a single resource, and consider judgment may be required to assess the relative risks and rewards of the different parties for the purpose of associating an asset with a specific entity.
   Another factor indicative of control (for the purpose of linking an asset to an entity) is an entity's ability to restrict or deny others' access to the benefits. The

absence of an entity's ability to restrict access either implies that the resource is freely available to all, which means that the resource is not a scarce economic resource that exhibits the essential characteristic of an asset or the asset is controlled by another entity.. An entity cannot intuitively be said to control an asset if it cannot restrict access of others to the asset's economic benefits.

Enforceable claim to benefits may be another strong indicator for linking a resource to an entity. However, as highlighted in paragraph 2.40 of the consultation paper, the absence of an enforceable and legal claim does not preclude an entity's access to economic benefits embodied in an asset. Accordingly, HoTARAC is of the view that an enforceable claim is another strong indicator of control (but not the primary criterion), as the absence of an enforceable claim does not necessarily mean that a resource should not be linked to an entity as an asset.

Other factors that have been found to be useful in practice for identifying control in the public sector have been adequately identified in the consultation paper. For example, an entity's access to the rights to benefit from a resource in meeting its objectives could be an indicator of control, however HoTARAC agrees that this concept is too broad when used on its own, as highlighted in paragraph 2.36.

(b) HoTARAC is of the view that an entity's enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others' access are not, on their own, adequate criteria for linking a resource to a specific entity. However, as commented above, HoTARAC is of the view that these factors, particularly the right to restrict or deny others' access to rights, provide indications as to whether control exists for linking a resource to a specific entity.

(c) HoTARAC has not identified any additional requirements.

Other comments:

HoTARAC believes it is important that there is a clear distinction between a government's right to benefit from the economic benefits embodied in an asset, and the rights the government obtains through its regulatory or legislative role.

In addition, IPSASB may want to consider the exercise of ownership rights of SNA 2008 as clarifying text to the risks and rewards view. Below is the relevant extract from SNA 2008.

> **7.11** In some cases, governments can create economic assets by exercising their sovereign powers or other powers delegated to them. For example, a government may have the authority to assert ownership rights over naturally occurring assets that otherwise would not be subject to ownership, such as the electromagnetic spectrum and natural resources in international waters subject to designation as an exclusive economic zone. These assets are economic assets only if the government uses its authority to establish and enforce ownership rights.

Specific Matter for Comment 3

Is it sufficient to state that an asset is a "present" resource, or must there be a past event that occurs?

HoTARAC does not consider a past event a necessary condition for the existence of an asset.

HoTARAC is supportive of the view that the primary criterion of an asset should be a "present" resource, with the existence of a past transaction or event being an indicator that an asset exists.

HoTARAC agrees that, at a minimum, an asset must be a present and unconditional resource as at reporting date for it to be recognised, or continued to be recognised, as an asset in the financial statements. This would avoid the issue identified in paragraph 2.46 that assets may no longer exist at reporting date.

HoTARAC's view is that a past event is not critical for the definition of an asset, and the focus and effort should be better applied to determine whether a 'present' resource exists at reporting date. HoTARAC notes that GFS includes the concept of produced and non-produced assets, with non-produced assets including natural resources that have not arisen as the result of a past event.

Specific Matter for Comment 4

Recognition and measurement criteria aside, are public sector entity rights and powers, such as those associated with the power to tax and levy fees, inherent assets of a public sector entity, are they assets only when those powers are exercised, or is there an intermediate event that is more appropriate?

HoTARAC believes rights to tax and levy fees are assets.

However, the definition of an asset should be separate from recognition criteria and assets such as a right to tax would be unlikely to fulfil the recognition criteria before a taxable economic event occurs.

Other comments:

HoTARAC supports the 'power' view for recognising assets arising from a public sector entity's rights and powers, such as those associated with the power to tax and levy fees. While a government has an inherent right to future benefits from taxes and fees from its constituents, this right is recognised as a government's enforceable claim on a specific taxpayer's economic resources once a taxable event has occurred. The government's inherent right is perpetual, and in contrast with other assets, never diminishes, regardless of the amount taxed in a particular period.

In this instance, HoTARAC is of the view that recognition on the government's financial statements should focus on its enforceable claim on a taxpayer's economic resource, which currently would be recognised when the tax event occurs. If the time the tax event occurs is not able to be reliably identified then the recognition point is when the tax is assessed. This approach is aligned with the Government Finance Statistic framework.

Specific Matter for Comment 5

(a) Are there any additional characteristics that have not been identified that you believe are essential to the development of an asset definition?

(b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of assets?

(a) HoTARAC has not identified any additional characteristics that are essential to the development of an asset definition.

(b) HoTARAC has not identified other relevant issues that the IPSASB needs to consider in determining the concept of assets.

Specific Matter for Comment 6

(a) Should the definition of a liability cover all of the following types of obligations?
- *(i) Obligations to transfer benefits, defined as cash and other assets, and the provision of goods and services in the future.*
- *(ii) Unconditional obligations, including unconditional obligations to stand ready to insure against loss (risk protection).*
- *(iii) Performance obligations.*
- *(iv) Obligations to provide access to or forego future resources.*

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

(a) HoTARAC recommends the Framework begin by defining a liability and suggests the definition should include:

- an obligation, which is a duty or responsibility to act or perform in a specific way;
- a future sacrifice of the entity's resources or assets is required;
- no realistic alternative to avoid the obligation exists; and
- a present obligation (an unconditional obligation) must exist at reporting date.

Accordingly, HoTARAC agrees obligations listed in (i) and (iii) above fall with the ambit of the suggested definition.

(a)(ii) Unconditional (stand ready) Obligations

HoTARAC recommends care be exercised in the recognition of unconditional stand-ready obligations as it is not always apparent when they exist and whether they are a present liability (e.g. HoTARAC questions the reporting of a ‘defence’ liability where there is an inherent “stand ready” obligation under international law to defend the country against outside attack). HoTARAC notes that stand-ready obligations may potentially require certain contingent liabilities and other obligations previously considered as executory contract obligations to be recognised as liabilities.

HoTARAC considers that unconditional stand-ready obligations may create challenges for the public sector, in particular in drawing the distinction between a conditional obligation and a stand-ready unconditional obligation as commented in paragraph 3.14. Accordingly, HoTARAC encourages the IPSASB to provide clear principles and further guidance in IPSAS to assist public sector entities in dealing with these issues in circumstances such as:

- government grants, as outlined in paragraph 3.18
- service concession arrangements
- international treaties and obligations under international law such as military commitments
- other non-exchange transactions, such as donations and government assistances for events such as natural disasters and epidemics
- whether time is considered a condition for non-exchange transactions.

(a)(iv) Obligation to provide access to or forego future resources

In relation to the notion of obligations to provide access to or forego future resources, HoTARAC noted that there is some question as to whether providing a right of access entails a transfer of resources for the obligation to meet the definition of a liability (refer paragraph 3.19). HoTARAC’s view is that obligations to provide access may be indicative of the existence of a liability, but should not be the defining criteria.

There is a view that to forego future resources does not require an outflow of the entity resources to settle the obligation and thus should not be identified as a liability. Alternatively, to forego future resources could be viewed as comprising two components: a claim against the entity ‘s future resources and the extinguishment of the obligation by the entity releasing/forgoing future resources.

Other comments:

In relation to the notion of performance obligations, while HoTARAC supports its inclusion as liabilities, further clarification is sought regarding the recognition criteria to be applied. For example, where a contract includes multiple performance obligations, would this lead to the recognition of multiple liabilities, all subject to individual recognition and measurement criteria?

(b) HoTARAC is of the view that settlement date should not be an essential characteristic of a liability. The essential characteristic should be whether the entity has a present obligation or another entity has an unconditional claim on the entity's resources as at reporting date.

Requiring a settlement date as an essential characteristic would exclude obligations that clearly exist but with an uncertain settlement date, such as lawsuits, insurance liability, long service leave provisions, etc. HoTARAC notes that paragraph 3.22 suggested using the criteria "on the occurrence of a specified future event', but this would further blur the distinction between conditional obligations and stand-ready obligations. For example, there are instances in Australia where a perpetual loan with no settlement date exists in the public sector which carries no ownership connotations.

Specific Matter for Comment 7

(a) Should the ability to identify a specific party(ies) outside the reporting entity to whom the entity is obligated be considered an essential characteristic in defining a liability, or be part of the supplementary discussion?

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

(c) Which of the three approaches identified in paragraph 3.28 do you support in determining whether an entity has or has not a realistic alternative to avoid the obligation?

(a) HoTARAC does not consider the identification of a counter party essential to the definition of a liability.

HoTARAC agrees that for a liability to exist, the obligation must be to an external party to the reporting entity. However, HoTARAC considers the ability to identify a specific party(ies) is only an indicator of an entity's obligation, and should not be part of the essential characteristics in defining a liability. For example, in some cases, a liability may be recognised without the need to identify a specific counter party and it is common for governments to have obligations to the general public rather than to specific parties (e.g. environmental / decontamination of sites). HoTARAC therefore supports including the counter party notion as part of the supplementary discussion.

HoTARAC supports the statements in paragraph 3.26 that "individuals with ownership-type interests acting in their capacity as owners are not considered "other parties"" and that "claims to an entity's residual interest that are capable of settlement only as a result of actions by the entity, are not liabilities of the entity."

(b) HoTARAC agrees that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability, because if the obligation can be avoided there is no claim on the entity's assets nor will there be a future sacrifice of the entity's resources or assets at that point. However, HoTARAC believes that the concept of unavoidability should be considered in conjunction with the obligating event being outside the control of the entity in developing a liability definition. HoTARAC also recommends further guidance should be included in the ED as to the definition of “realistic”, in particular when dealing with unique public sector obligations. For example, would the government’s inherent powers to avoid obligations be classified as a realistic power?

(c) HoTARAC supports approach (c) (the third approach) as outlined in paragraph 3.35. HoTARAC is of the view that “if… the evidence as a whole raises a valid expectation for the entity to perform [and] the entity cannot realistically withdraw from it’ and other definition elements are met, then it meets the liability definition. HoTARAC also believes approach (c) (as explained in paragraph 3.28) better reflects the substance of public sector entity’s obligations and role. As commented in our response to 7(b) above, HoTARAC suggests examples and guidance be provided to illustrate situations where an entity may not realistically be able withdraw from its previous obligations.

(d) The CP discusses the issue of a government ‘s budget and whether the approval of the budget results in an obligation, particularly with regards to social benefits. HoTARAC is of the view that these are estimates and intent of the government, but not an obligation as they are still conditional on the claimants/recipients to lodge a valid claim and/or the relevant event to occur (i.e. health problems, unemployment or disaster). In Australia, special appropriations allowed any citizen eligible to claim a government payment if the claim meets the criteria, in this instance, the budget estimates a realistic amount but does not set a limit on the resources that will need to be transferred to recipients.

Other comments

HoTARAC recommends the IPSASB consider providing further clarity and guidance to highlight the principal differences between approaches (a), (b) and (c), as the current wording is difficult to interpret.

HoTARAC also recommends the IPSASB consider that limiting liabilities to enforceable obligations under approach (a) would require exemptions in cases where public sector entities do not have distinct legal personalities, and transfers between them are not contractually, constructively or equitably enforceable (for example, tax equivalent payments).

Specific Matter for Comment 8

Is it sufficient to state that a liability is a “present” obligation, or must there be a past event that occurs?

Consistent with HoTARAC’s response to Specific Matter for Comment 3 above, HoTARAC supports the view that the primary criterion of a liability should be a “present” obligation. However, a strong indicator for the existence of a “present” obligation may be the existence of a past transaction or event.

Specific Matter for Comment 9

(a) Recognition and measurement criteria aside, are public sector entity obligations such as those associated with its duties and responsibilities as a government, perpetual obligations, obligations only when they are enforceable claims, or is there an appropriate intermediate event that is more appropriate?

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

(c) Should the definition of a liability include an assumption about the role that sovereign power plays, such as by reference to the legal position at the reporting date?

(a) HoTARAC notes that not all obligations can be recognised as liabilities and believes IPSAS should acknowledge this in framing the question. Only some obligations qualify as the more restrictive liabilities. Perpetual obligations, such as social benefits currently do not qualify as liabilities until all substantive obligations are met, and HoTARAC would support continuation of this approach.

Only obligations that satisfy the liability definition should be recognised, which is consistent with accrual principles (refer to Specific Matter for Comment 7).

(b) As indicated in our comments in Specific Matter for Comment 7(c), HoTARAC does not support the view that enforceability of an obligation is an essential characteristic of a liability. The essential characteristic of a liability should be focus on the notion of absence of a realistic alternative to avoid the obligation, rather than enforceability. Having said that, HoTARAC supports the view that enforceability does provide a strong indication that an entity has no realistic alternative.

(c) No. HoTARAC does not believe the definition of a liability should include an assumption about the role that sovereign power plays, as there are various legal structures and dynamics across countries. However, this notion may be considered as part of a disclosure requirement in a relevant IPSAS

Specific Matter for Comment 10

(a) Are there any additional characteristics that have not been identified that you believe are essential to the development of a liability definition?

(b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of liabilities?

None identified, subject to our comments above.

Specific Matter for Comment 11

> *(a) Should revenues and expenses be determined by identifying which inflows and outflows are "applicable to" the current period (derived from a revenue and expense-led approach),or by changes in net assets, defined as resources and obligations, "during" the current period (derived from an asset and liability-led approach)?*
>
> *(b) What arguments do you consider most important in coming to your decision on the preferred approach?*

(a) HoTARAC supports the asset and liability-led approach and therefore revenue and expenses should be determined by changes in assets and liabilities over the period.

HoTARAC acknowledges that performance reporting in public sector has a different role than for private sector, although it should be an accountability tool it is also important to provide information on the efficiency or inefficiency as the case maybe in using the entity's resources to deliver services to the public. A net cost of services presentation can help this.

Further, in the public sector the financial performance statement is the main focus, the balance sheet is viewed by GPFRs users as secondary. However, HoTARAC supports the asset and liability-led approach as it is conceptually superior to the proposed alternative and all changes in the balance sheet are reflected in the financial performance statement, albeit HoTARAC prefers the reporting of some transactions separately on the face of the statement (e.g. IASB - Other Comprehensive Income or GFS - Other Economic Flows).

(b) HoTARAC supports the asset and liability-led approach due to representational faithfulness and objectivity, and notes that the asset and liability-led approach is consistent with the approach used under current Australian GAAP, IPSAS, IFRS and GFS.

HoTARAC believes the concept of representational faithfulness is better aligned when financial statements' elements are based on objective measure of economic phenomena. This enhances the representation of resources and flows by requiring the reporting entity to assess information about economic events that have transpired during the reporting period.

Other comments:

HoTARAC also supports the asset and liability-led approach for the reason outlined in paragraph 4.26, as it provides better focus on a public sector entity's resources available to provide future services, obligations to transfer resources to others, and the net resources available to finance future obligations.

HoTARAC notes the comment in paragraph 4.27 that the concept of financial performance must be selected to develop a definition of revenues and expenses. HoTARAC questions, however, on how revenue and expenses can be defined without reference to the concept of resources, rights and obligations that underpin the definition of assets and liabilities. Without a properly defined concept of wealth or resources, there is no focus on the economic events affecting wealth over the period and, consequently no measure of the efficient use of resource. This is particularly relevant to public sector entities where there is less focus on profit generation.

HoTARAC acknowledges that the revenue and expenses-led approach has been pioneered by the US Government Accounting Standards Board, which allocates expenses to period in which the services are provided and revenues are attributed to the period in which they were intended to fund those services. However, it appears that the process of linking flows to the current period operations or provision of service/programs requires significant judgement by the entity and hence subjectivity is an issue that will impact on the understandability, consistency, and comparability of the information.

Further, HoTARAC has three main issues with the revenue expense-led approach as outlined in the document:

- the revenue and expense led approach applies a form of matching principle for its allocation of asset/liability to the current period based on current expenses. The rationale for the proposed expense and revenue allocation is not to reflect the actual economic phenomena, but as presented in the Consultation Paper, appears to be based on the view that **revenue should match the expenses**. This is a departure from the faithful representation qualitative characteristics (i.e. is it a true representation of the transaction that the revenue of the entity should match the expenses?). The allocation process itself is arbitrary and subjective, and the expense is often itself based on a subjective/estimates of the asset consumption (i.e. depreciation/amortisation);
- there are consequences of this arbitrary allocation which impacts on the financial performance statement and its usefulness for users. For example, the assessment of the an entity's management performance could be hidden because matching revenue with expenses does not provide any indication on the efficiency of the service delivered;
- if revenue expense-led were adopted, then deferred inflows and outflows should be included as separate elements on the balance sheet, however there is a question as to whether some of the deferrals under the revenue expense-led approach would meet the definition of assets and liabilities.

HoTARAC believes the IPSASB may consider the concept of other comprehensive income used under IFRS and other economic flows used under GFS in the presentation in the performance statement of valuation adjustments as an alternative to the concept of deferrals.

HoTARAC would like to see more detailed examples in the paper and feel the current examples are too simplistic. It is recommended that IPSASB use more comprehensive examples to demonstrate how these concepts would apply from year to year, and compare the financial impacts between the expense revenue led and the asset liability led methods over a number of years. HoTARAC would like to see a wider range of transactions such as. valuation changes, losses/writeoffs, changes to expected amount/timing of transactions etc in the paper to encourage more informed future input from constituents

HoTARAC would prefer the response to focus on whether the revenue expense approach of linking flows to the current period operations or provision service/programs would meet the proposed qualitative characteristics, and if it is therefore unlikely to meet user needs. However, at the moment subjectivity concerns are subordinate to the more fundamental concerns.

Specific Matter for Comment 12

(a) Should transactions with residual/equity interests be excluded from revenues and expenses?

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

(a) HoTARAC supports the concept that transactions with owners as owners should be excluded from the performance statement when there is an ownership interests (i.e. equity interest). As in the corporate sector, government should recognise these transactions separately from the performance statement. Given that IPSASB Conceptual Framework is proposed to be applicable at the reporting entity level, the concept of ownership interest should be retained. At the consolidated level, ownership interests are subsumed into net worth (i.e. residual amount).

Distinguishing between revenue and capital funding in the GFS General Government sector and between General Government and its business entities is important in assessing financial performance of the General Government sector units within that sector.

(b) HoTARAC recommends that IPSASB consider the similar concepts of IFRS “Other comprehensive income” and GFS “Other economic flows”, to allow users to distinguish between transactions and valuation adjustments.

HoTARAC notes IPSASB attempts to minimise divergence from the GFS reporting model. In Australia, an attempt has been made to harmonise government reporting under GAAP with the Government Finance Statistics Framework. One of the harmonising requirements is the distinction between increases in net worth, arising from transactions (defined as mutually agreed interactions between enterprises) which are recognised as revenue, and other changes in volume or value of assets (recognised as other economic flows). The channelling of valuation adjustments to other comprehensive income facilitates this process.

HoTARAC supports the proposal in paragraph 4.48 as providing additional information that is useful and relevant to users by making such distinction, however, this should be based on a sound conceptual basis, not decided on a standard basis (i.e. current IASB approach), and thus should be defined in the Conceptual Framework.

Other Comments

HoTARAC notes that the definitions need to be clear because different terminology has at times been applied to the same concept (e.g. in the Asset/Liability approach, revenue can be split between 'revenue' and 'other income', on the other hand 'revenue from transactions' could align with revenue as defined in the Revenue & Expense approach).

Specific Matter for Comment 13

(a) Are there any additional characteristics that have not been identified that you believe are essential to the development of definitions of revenues and expenses?

(c) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the definitions of revenues and expenses?

See comments under 12 (above)

Specific Matter for Comment 14

(a) Do deferrals need to be identified on the statement of financial position in some way?

(b) If yes, which approach do you consider the most appropriate? Deferred outflows and deferred inflows should be:
(i) Defined as separate elements;
(ii) Included as sub-components of assets and liabilities; or
(iii) Included as sub-components of net assets/net liabilities.

(c) If defined as separate elements, are the definitions of a deferred outflow and deferred inflow as set out in paragraph 5.8 appropriate and complete?

Refer in part to comments under 11 (above)

(a) HoTARAC favours the assets and liabilities-led approach and does not support the identification of deferrals if they do not meet the definition of assets and liabilities, as these would not faithfully represent the economic phenomena.

Valuation changes should be reported as other comprehensive income as a means of allowing users to distinguish between the impacts of transactions and the impacts of valuation adjustments to assets and liabilities.

(b) No response required.

(c) HoTARAC does not support the use of deferrals, but provides the general comment that the definitions are neither appropriate nor complete. [Refer to comments on the asset liability and revenue expense approaches]. The definitions of 5.8 mirror those of GASB, but do not clearly distinguish deferrals from other balance sheet elements. For example, a deferred outflow is defined as 'a consumption or reduction of net assets applicable to future reporting periods'. This begs the question as to whether capitalised restoration costs (AASB 116.16, IPSAS 17.30(c)) concomitantly qualify as both assets and deferrals, and how this should be treated in practice.

Specific Matter for Comment 15

(a) Do you consider net assets/net liabilities to be a residual amount, a residual interest, or an ownership interest?

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

(c) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of net assets/net liabilities?

This matter has been discussed, in part, under 12 (above).

(a) HoTARAC considers net assets/net liabilities to be a residual amount. Any ownership (minority) interest on this residual amount can be treated as a sub-class of this residual amount.

HoTARAC considers that the concept of ownership exists in government, but more due to government having, and exercising, the legal power and authority as an owner rather than through conventional equity ownership, i.e. it is often not an expectation of government to earn a return on the funds invested in one of its owned entities. However, this can differ markedly between sectors of government, with entities in the corporations sectors more likely to be required to be run on conventional private sector business lines. Entities in the General Government Sector are more likely to have efficiency-related operating conditions imposed, rather than any requirement for a return on capital invested. It should be noted also that Government's ownership interest and authority in its entities exists often through statutory means rather than through the issue of formal equity instruments. If the entity were wound up, the net assets of the entity would likely return to government as the legal owner and to minority interest as equity owner (if any).

HoTARAC agrees with comment made in paragraph 5.19 in that Government has an interest in the entity, and has the authority to direct the operating and financing activities of the entity. Government can also require an entity to give up its resource to another entity, such as through machinery of government changes that may impact on its future ability to provide goods/services.

HoTARAC views all the above as government acting in its capacity as owner rather than as *interest in the capability of the entity to finance itself and to resource future operations* (paragraph 5.18). Therefore, HoTARAC proposes that the scope of 'ownership interest' be broadened to include such ownership interest for public sector entities in addition to the third parties only 'ownership interest'.

HoTARAC would also support discussion of distinguishing between government funding in it capacity as owner (equity) and other (non-equity) government funding to its controlled entities at the General Government sector level. HoTARAC recommends the following criteria be used for defining government ownership transactions:

(a) the government can exert control over its own investment, such as being able to sell its investment without unreasonable impediments;

(b) the investment entitles the government to a claim on the entity's net assets;

(c) there is a reasonable expectation of recovery of the investment; and

(d) the investee must be a GFS non-General Government Sector (non-GGS) entity. A government cannot invest in itself nor in another government.

(b) Consistent with our comment above, the concept of 'ownership interests' should be broadened and defined, but not as part of the element definition. HoTARAC supports, when relevant, including the concept of outside interests as minority or non-controlling as it shows information about the external claims on the entity's net assets.

(c) HoTARAC believes there should be some discussion on the transfer of resources between units within the general government sector. For example, this might arise as a result of a government decision to restructure its internal functions. In these circumstances, are the resources transferred directly between the units or do they represent a change in ownership interests by the controlling unit? This also comes back to the issue of differing concepts of 'ownership' discussed in (a) above, in relation to sectoral and consolidated reporting. For example, in the GFS framework, the General Government Sector represents the controlling interest in the other sectors of government. However, at the whole of government consolidated level this notion 'government' as owner virtually disappears.

Specific Matter for Comment 16

(a) Should transactions with residual/equity interests be defined as separate elements?

(b) If defined as separate elements, what characteristics would you consider essential to their definition?

As stated above in response to Specific Matter for Comment 12(a) and 15, HoTARAC supports net asset/liability being a residual amount. Accordingly it is not a separate element and a definition is not required.

Specific Matter for Comment 17

(a) Should recognition criteria address evidence uncertainty by requiring evidence thresholds; or by requiring a neutral judgment whether an element exists at the reporting date based on an assessment of all available evidence; or by basing the approach on the measurement attribute?

(b) If you support the threshold approach or its use in a situational approach, do you agree that there should be a uniform threshold for both assets and liabilities? If so, what should it be? If not, what threshold is reasonable for asset recognition and for liability recognition?

(a) HoTARAC supports a threshold for the recognition of accounting elements. It is recommended that three criteria are to be satisfied before an accounting element can be recognised. The first criterion is that the definition of an accounting element must be met. The second criterion is that it is “probable that the item embodies economic benefits for the entity / will require future sacrifice of the entity’s resources”. The third criterion is that the accounting element or transaction must embody the qualitative characteristics (e.g faithful, relevance, verifiability, etc...).

(b) HoTARAC supports a uniform threshold of probable. A situational approach would appear to be a more faithful representation and would be consistent in, some way, with IFRs and GFS. HoTARAC has previously opposed the elimination of probability recognition criteria in its response to IASB ED/2010/1 *Measurement of Liabilities in IAS 37 (Proposed amendments to IAS 37)*.

Other comments

HoTARAC prefers the ‘probable’ threshold and believes that a clear definition and guidance on the phrase needs to be provided.

However, HoTARAC notes that IFRS aligns better with the proposed approach based on the measurement attribute, most likely because IFRS proposals are based on a market value and thus does take into account probability in the measurement. Given that government assets are more likely to be measured at depreciated replacement cost, it makes for an argument to apply a probability threshold.

Specific Matter for Comment 18

Do you support the use of the same criteria for de-recognition as for initial recognition?

For the same reason as IPSASB (stated in paragraph 6.25), HoTARAC supports the use of the same threshold for initial recognition and subsequent de-recognition of assets and liabilities, as this is consistent with the qualitative characteristic of faithful representation.

Other comments:

It is recommended IPSASB, when reviewing IPSASs for consistency with its Framework, revisits the ‘virtual certainty’ test for contingent assets of IPSAS 19.

Specific Matter for Comment 19

Should the recognition criteria be an integral part of the element definitions, or separate and distinct requirements?

HoTARAC’s recommends the recognition criteria be separate and distinct from the element definition. This keeps the element definition at a high level and simpler to understand. Separate definitions are useful for preparers in providing a structure for the recognition of balance sheet items and is used currently in distinguishing contingencies from assets and liabilities.

OTHER COMMENTS

Australia has adopted a single set of accounting standards and framework applying to both the public and private sector that are based on IFRS. Therefore, HoTARAC proposes that IPSASB works closely with IASB in the development of the conceptual framework for public sector with the aim of achieving, as far as possible, a uniform conceptual framework between the two bodies, with IPSASB considering the issues on their own merits from a public sector perspective.

HoTARAC believes that having a single set of accounting standards for both private and public sectors allows comparability and consistency of financial reporting between the two sectors.

Inconsistent numbering and grouping

Matters are numbered and grouped inconsistently. The sections on deferrals and equity are split, rather than being presented sequentially. Matters 12, 15 and 16 relate to equity; matters 11 and 14 relate to deferrals. HoTARAC also notes Specific Matter for Comment 2(b) is a restatement of 2(a)(iii), ‘access to rights’, with the addition of the concept of enforceability and these should be combined in the final Exposure Draft is released, and the final ED could be simplified by grouping and consolidating the Matters for Comment.

Comparison with GFS

IPSAS states in the preamble that IPSASB is committed to convergence with GFS where appropriate, but a number of the matters are not compatible with GFS. It is recommended CF Phase 2 uses the same format of footnoting GFS requirements as CF Phase 3 stating the relevant requirements of GFSM 2001 in the eventual Exposure Draft.

Minor Errors

There is an apparent error in paragraph 2.22, where "**or**" should read "**but**"

> "should not hinge on whether payment has been made **or** whether, at the reporting date, the entity has a binding obligation to transfer resources in the future".

Paragraph 2.36 paraphrases the 'Access to the Rights' approach as a 'right of access', which is fundamentally different from a right or access.