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International Public Sector Accounting Standards Board

International Federation of Accountants

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Dear Stephenie,

**COMMENTS ON PHASE I, II AND III OF THE IPSASB'S CONCEPTUAL FRAMEWORK PROJECT**

We welcome the opportunity to provide comments on Phases I, II and III of the IPSASB's conceptual framework project. Overall, we are supportive of the project as we believe it makes significant strides in strengthening transparency and accountability in public sector financial reporting.

Enclosed are our comments on:

- The Exposure Draft on Phase I – *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority, and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity.*
- The Consultation Paper on Phase II – *Elements and Recognition.*
- The Consultation Paper on Phase III - *Measurement of Assets and Liabilities*.

This comment letter has been prepared by the Secretariat and does not necessarily reflect the views of the ASB Board. In formulating the comments outlined in this letter, the Secretariat has consulted a variety of stakeholders in the South African public sector, including auditors, preparers, professional bodies and academia.

As acknowledged in the various documents issued for comment, it may be necessary for the IPSASB to issue a complete Framework for comment once the various phases are complete. Based on the final outcome of the Framework, the views expressed in this letter may be subject to change.

Just as financial statements on their own may not provide sufficient information for accountability and decision-making under the accrual basis of accounting, the statement of receipts and revenues along with disclosures may not provide sufficient information under the cash basis of accounting. We therefore recommend that the IPSASB consider developing a separate Framework for the cash basis of accounting as this would be useful to supplement existing information either required or disclosed under the Cash Basis IPSAS.

Please feel free to contact me should you require clarification on any of our comments.

Yours sincerely

Erna Swart

Chief Executive Officer

| Phase II – *Elements and Recognition* | | |
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| | **Question 1** | **(a) Should the definition of an asset cover all of the following types of benefits—those in the form of:**<br>**(i) Service potential;**<br>**(ii) Net cash inflows; and**<br>**(iii) Unconditional rights to receive resources?**<br>**(b) What term should be used in the definition of an asset:**<br>**(i) Economic benefits and service potential; or**<br>**(ii) Economic benefits?** |
| | | *Response to question*<br>The definition of an asset should cover both service potential and net cash inflows. To reinforce the consideration of both service potential and net cash inflows in identifying assets, it is proposed that the term "economic benefit and service potential" should be used.<br>We question whether "unconditional rights to receive resources" are benefits of an asset. We would contend that unconditional rights are a way in which economic benefits and/or service potential arise. |
| | | *Other comments*<br>The section on liabilities indicates the following:<br>• Liabilities are noted as arising from "obligations". A similar notion has not been reflected in the discussion on assets. In developing the definitions of assets and liabilities, it should be considered whether symmetry in these definitions is important. For example, liabilities are "obligations" to transfer economic benefits or service potential; similarly, assets should be "rights" to receive economic benefits or service potential. These rights can arise from ownership rights, contractual rights and rights arising from legislation.<br>• "Social benefits" are seen as an unconditional obligation. Similarly, the opposite may be true for the right to tax. We would therefore suggest that the right to tax be explored as an unconditional right in the subsequent phases of the project.<br>• It is noted that liabilities can arise from a variety of obligations (specific matter for comment 6). It is questioned whether the opposite side of these transactions should be considered from an asset perspective. For example, how or could an asset arise for an entity that is the counterparty to a transaction that gives rise to a performance obligation? These types of arrangements are prevalent when transfers are made from one level of government to another. |
| | **Question 2** | **(a) Which approach do you believe should be used to associate an asset with a specific entity:**<br>**(i) Control;**<br>**(ii) Risks and rewards; or**<br>**(iii) Access to rights, including the right to restrict or deny others' access to rights?**<br>**(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?**<br>**(c) Are there additional requirements necessary to establish a link between the entity and an asset?** |

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| | | *Response to part (a)*<br>The three approaches outlined in the Consultation Paper, are not mutually exclusive. Where, for example, a control approach is used, consideration of the risks and rewards related to the asset may provide a useful indication of whether control exists. Similarly, the access to rights may also be an indicator of control.<br>We support that "control" should be used to attribute an asset to an entity, with "risks and rewards" being an indicator of whether control exists. "Control" is favoured over a risks and rewards approach as it may be difficult to apply the concept of risks and rewards in the public sector where, for example:<br>• Assets are used by more than one entity, e.g. each entity may determine that it bears risk related to the asset and shares in the benefits. Accounting for assets using only such an approach (even if on the basis of "majority" benefits) may be subjective.<br>• The intention of an arrangement is the sharing of risk, e.g. service concession arrangements. |
| | | *Response to part (b)*<br>An "enforceable claim" does link a resource to an entity, although it is not the only means of linking a resource to an entity. As noted in the response to SMC 1 above, it is important to indicate how a resource arises for an entity, e.g. through a "right" or similar means.<br>We consider the existence of an "enforceable claim" provides evidence that supports the recognition of an asset rather than it being a characteristic that defines an asset, i.e. a resource meets the definition of an asset because an entity has rights to receive economic benefits and/or service potential, but that those resources are only recognised as an asset when the rights are enforceable. |
| | | *Response to part (c)*<br>Resources may be attributed to an entity in a variety of ways. The Consultation Paper explains that these resources may arise from contractual rights. They may, however, also arise through legislation. For example, taxes, fines and appropriations receivable are typical examples of resources that arise from legislation rather than the conclusion of a contract. |
| | **Question 3** | **Is it sufficient to state that an asset is a "present" resource, or must there be a past event that occurs?** |
| | | The word "present" implies that a something must have happened in the past to give rise to a "present resource". As a result, we are of the view that regardless of whether "present" is used in the asset definition, or specific reference made to a "past transaction of event", the result is the same. We do however support the principle that an event must occur to give rise to an asset and, as a consequence believe that using the word "present" captures this concept.<br>During our deliberations on what is meant by a "present" resource, it was suggested that the Framework should explicitly state that executory contracts should not be recognised. We would support the view that executory contracts meet the definition of assets and liabilities as they give rise to rights and obligations. The fact that they should not be recognised as either an asset or liability depends on the recognition criteria developed. As an illustration, executory contracts will only be recognised once an enforceable claim exists, which will only arise when one of the parties performs. Until that point, the recognition criteria are not met. Also see our comments under specific matter for comment 2 on "enforceable claim" and specific matter for comment 17 on recognition criteria. |
| | **Question 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** |

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| | | **exercised, or is there an intermediate event that is more appropriate?** |
| | | We are of the view that rights are not inherent assets of an entity and support the view that assets only arise once a right has been exercised. The existence of a right in itself does not give rise to a claim to economic benefits or service potential. It is an event or action related to the exercise of this right that gives rise to an asset. For example: The right to tax may exist at reporting date. Without a taxpayer earning taxable income during the reporting period, there is no right to collect tax and consequently no economic benefits will be received.<br>While we acknowledge the view that a government or public sector entity has both rights and obligations into perpetuity, it is important to consider what assets and liabilities exist based on the exercise of these rights at a point in time, i.e. at the reporting date. |
| | **Question 5** | **(a) Are there any additional characteristics that have not been identified that you believe are essential to the development of an asset definition?**<br>**(b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of assets?** |
| | | *Response to part (a)* |
| | | Refer to comments made under SMC 1. |
| | | *Response to part (b)* |
| | | Governments and other public sector entities often have stewardship over a variety of natural and other resources such as conservation areas, fauna, flora and marine life. In developing the definition of an asset, it would be useful if these types of resources could be considered in developing the definitions of assets. |
| | **Question 6** | **(a) Should the definition of a liability cover all of the following types of obligations?**<br>**(i) Obligations to transfer benefits, defined as cash and other assets, and the provision of goods and services in the future.**<br>**(ii) Unconditional obligations, including unconditional obligations to stand ready to insure against loss (risk protection).**<br>**(iii) Performance obligations.**<br>**(iv) Obligations to provide access to or forego future resources.**<br>**(b) Is the requirement for a settlement date an essential characteristic of a liability?** |
| | | *Response to part (a)*<br>We agree that the following obligations should be considered in formulating the liability definition:<br>A. Obligations to transfer benefits, defined as cash and other assets, and the provision of goods and services in the future.<br>B. Unconditional obligations.<br>C. Performance obligations<br>We suggest that the wording proposed for assets regarding “net cash inflows” and “service potential” should be replicated in the liability definition.<br>Obligations to provide access to or forego future resources are not separate obligations that require consideration. Obligations to provide access or forego future resources could |

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| | | be considered as a type of obligation that arises from the three liabilities listed above. |
| | | *Response to part (b)*<br>Reference to a "settlement date" is not an essential characteristic of a liability. Where a settlement date is not specified, this may add complexities to the measurement of the liability, but would not mean that an obligation does not exist. The key feature of a liability is that an obligation exists to pay/transfer economic benefits or service potential to another party. |
| | **Question 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?**<br>**(b) Do you agree that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability?**<br>**(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?** |
| | | *Response to part (a)*<br>An entity cannot have an obligation to itself. Obligations only arise with parties external to the reporting entity as such parties would have the ability to require the reporting entity to fulfil its obligation. It is however not necessary that the exact identity of the third parties be known for an obligation to exist. For example, a government commits to award 1,000 qualifying students with bursaries for a particular academic year. As the government has committed to provide bursaries, the obligation exists despite the fact that the identities of the 1,000 students may not be known at reporting date. |
| | | *Response to part (b)*<br>We would support the view that whether or not there is a "realistic alternative to avoiding the obligation" is critical in recognising a liability. We would see the existence of an obligation as being the characteristic that is important in defining a liability. The fact that an entity has no realistic alternative but to avoid the obligation would mean that the obligation should be recognised. |
| | | *Response to part (c)*<br>Instead of analysing whether legal and constructive obligations exist for exchange and non-exchange transactions, we would support the development of a broad principle that addresses the existence of obligations related to these transactions. We would support a principle that considers the existence of an obligation based on a past event, and the recognition of a liability where an obligation is enforceable.<br>For example: A government may have a policy and history of providing housing to indigent families. While this may create an expectation that houses will be provided to all indigents the existence of a policy or past history does not give rise to an obligation. In our proposal, a liability will not exist until an indigent family makes a successful application to receive a house in a particular housing development (past event that meets the definition of a liability) and the government's obligation to provide this house can be enforced through legislation or similar means (event give rise to an enforceable claim).<br>It is important to note that for many social benefits provided, the receipt of those benefits may be similar to a "contractual arrangement" that is concluded in an exchange transaction. A citizen often applies or requests to receive certain goods or services, which the government then agrees to provide. The existence of this type of "contractual arrangement" reinforces the notion that such liabilities only arise when they are enforceable (as a result of a past event, which is the agreement reached in the contract).<br>For exchange transactions, an enforceable claim would arise where the obligation can be |

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| | | enforced by contractual and other legal rights, or by courts or similar means. It may also be appropriate to consider whether there is an expectation that a liability would be enforced by a court based on common law. |
| | **Question 8** | **Is it sufficient to state that a liability is a "present" obligation, or must there be a past event that occurs?** |
| | | See the response to SMC 3 on assets. The same response applies to liabilities. |
| | **Question 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?**<br>**(b) Is the enforceability of an obligation an essential characteristic of a liability?**<br>**(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?** |
| | | *Response to part (a)*<br>As noted in our response to SMC 4, a government or public sector entity may have an obligation or an ongoing obligation to provide certain resources. However, until a specific event has occurred that compels the entity to transfer economic benefits or service potential to another party (i.e. the other party can enforce the obligation), a liability cannot be recognised. |
| | | *Response to part (b)*<br>If an obligation arises from a contract, legislation or past actions/behaviours, it implies that the obligation is enforceable. While enforceability is necessary, it is questioned whether this should be an explicit requirement in the definition of a liability. |
| | | *Response to part (c)*<br>As noted in specific matters for comment 4 and 9, rights and obligations should be assessed at a point in time, i.e. at reporting date. As a result, obligations should be assessed based on contracts and legislation in force at the reporting date. The existence of an obligation cannot be negated by future changes that may or may not be made and approved by a government. |
| | **Question 10** | **(a) Are there any additional characteristics that have not been identified that you believe are essential to the development of a liability definition?**<br>**(b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of liabilities?** |
| | | We could not identify any additional characteristics or other issues that require consideration in the development of a definition for liabilities. |
| | **Question 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)?**<br>**(b) What arguments do you consider most important in coming to your decision** |

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| | | **on the preferred approach?** |
| | | We support the assets and liabilities approach for the following reasons:<br>• Using the definitions of an asset and a liability provide a firm or definite "anchor" within which to define revenues and expenses, i.e. any changes in assets and liabilities can be viewed as revenues and expenses.<br>• If assets and liabilities are not used as "anchors" to define revenues and expenses, it may be very difficult to develop a principle that can be applied consistently to the recognition and/or deferral of revenues and expenses.<br>• The asset and liability approach is more consistent with the statistical basis of accounting which views the statement of financial performance or income statement as the change in the "stocks" held by an entity.<br>We do however acknowledge that:<br>• The presentation of certain revenues and expenses, such as fair value gains and losses, may need to be considered at a standards-level if the asset and liability approach is used.<br>• The inter-period matching of revenues and expenses that result from the revenue and expense approach may provide useful information to the users of the financial statements. As such, it may be useful to provide this information as a disclosure to the financial statements and/or as an additional statement in the GPFSs or GPFRs. This information could be viewed as the first year of an inter-generational report that would provide information about whether current year taxpayers paid for the services they received in that period. A longer term inter-generational report could be prepared as an extension of this information and analyse whether the benefits received by various generations are equitable. |
| | **Question 12** | **(a) Should transactions with residual/equity interests be excluded from revenues and expenses?**<br>**(b) Should the definitions of revenue and expense be limited to specific types of activities associated with operations, however described?** |
| | | *Response to part (a)*<br>Revenues are received in exchange for goods and services provided or, for the use of an entity's assets. Revenues are usually used by an entity to fulfil its mandate. Contributions from owners are received in return for a right to an interest in an entity, and is regarded as the capital of the entity. As the substance of the inflow is different, contributions from owners should be distinguished from revenue. |
| | | *Response to part (b)*<br>While revenues and expenses may be attributed to specific activities, they arise from either changes in assets and liabilities or from events that occur in a specific period. The activities to which assets and liabilities or events relate is irrelevant in determining whether they are revenues or expenses in nature. The definitions of revenues and expenses should therefore not include only revenues and expenses that arise from specific activities. We would however note that it may be important to consider whether presentation of information on the various activities of an entity may be useful to users of the financial statements. For example, it may be appropriate to provide information in the cash flow statement about revenues and expenses arising from operating, investing and financing activities. This can however be achieved by considering presentation requirements at a standards-level. |

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| | **Question 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?**<br>**(b) 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?** |
| | | We could not identify any additional characteristics or other issues that require consideration in the development of definitions for revenues and expenses. |
| | **Question 14** | **(a) Do deferrals need to be identified on the statement of financial position in some way?**<br>**(b) If yes, which approach do you consider the most appropriate? Deferred outflows and deferred inflows should be:**<br>**(i) Defined as separate elements;**<br>**(ii) Included as sub-components of assets and liabilities; or**<br>**(iii) Included as sub-components of net assets/net liabilities.**<br>**(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?** |
| | | Based on our response to specific matter for comment 11, we do not believe that deferred inflows or outflows should be defined as elements. |
| | **Question 15** | **(a) Do you consider net assets/net liabilities to be a residual amount, a residual interest, or an ownership interest?**<br>**(b) Should the concept of ownership interests, such as those that relate to minority or noncontrolling interests in a GBE, be incorporated in the element definition?**<br>**(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?** |
| | | *Response to part (a)*<br>Net assets/net liabilities is the net result of an entity's assets and liabilities and therefore represents a "residual amount". An ownership or residual interest may however be held over the "residual amount" of an entity. Whether a residual interest or ownership interest exists, may depend on the type of entity. For example:<br>• The residual amount of a government agency or unit may represent the taxpayers' residual interest in the net resources available for the provision of future services.<br>• The residual amount of an entity with share capital (stock) may represent the shareholders' ownership interest in the net assets of the entity. |
| | | *Response to part (b)*<br>In the South African public sector, entities do exist that have ownership interests similar to those of GBEs and private sector companies. We would therefore support the concept of an "ownership interest". It is not necessary to consider controlling and non-controlling interests at the level of the conceptual framework; this is a standards-level issue. |
| | | *Response to part (c)*<br>We could not identify any additional characteristics or other issues that require |

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| | | consideration in the development of concepts related to net assets/net liabilities. |
| | **Question 16** | **(a) Should transactions with residual/equity interests be defined as separate elements?**<br><br>**(b) If defined as separate elements, what characteristics would you consider essential to their definition?** |
| | | *Response to part (a)*<br>Residual or equity interests should be distinguished from other elements. Consequently, they should be identified as a separate element. As various interests may be held over the residual amount of an entity (i.e. a residual or ownership interest), residual interests and ownership interests could be defined as a sub-set of the residual amount (net assets/net liabilities). |
| | | *Response to part (b)*<br>We are of the view that the characteristics already listed in paragraph 5.34(a) to (c) are essential in defining a residual or ownership interest. The characteristic in paragraph 5.34(d) is not unique to residual or ownership interests; they are also characteristics of liabilities. |
| | **Question 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?**<br><br>**(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?**<br><br>**If not, what threshold is reasonable for asset recognition and for liability recognition?** |
| | | *Response to part (a)*<br>Conceptually, if rights or obligations exist that otherwise meet the definition of assets and liabilities, they should be recognised. The extent to which they are likely, probable or certain should be reflected in their measurement. It may however be questionable whether such information would be useful to users of the financial statements, and whether in fact the information would be understandable as complex measurement techniques would need to be used.<br>From this perspective, it may be useful to impose a “hurdle” for the recognition of assets and liabilities in the financial statements. This would ensure that only those assets and liabilities that meet a threshold (e.g. the inflow of benefits is probable or certain) are recognised, and would provide a consistent basis for users to understand what it means when these items are reflected on the financial statements.<br>In applying this “hurdle”, it is anticipated that a two-step approach is followed in recognising assets and liabilities:<br>1. An entity assesses whether it meets the definition of an asset or a liability.<br>2. An entity assesses whether the asset or liability meets the recognition criteria.<br>We are cognisant of the fact that the thinking in the private sector may be to combine a “hurdle” such as probability, into the measurement of an asset and a liability. It may be appropriate to apply such an approach to the private sector where the main objective is to value the business, determine a share price and quantify risk. The objectives for preparing GPFSs in the public sector are different and, as a result, a different approach to recognising assets and liabilities may be justified in the public sector. |

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| | | *Response to part (b)*<br>The recognition criteria for assets and liabilities should be similar. Historically, the recognition of assets has been relatively conservative, while the opposite is true for liabilities. This skewed approach to the recognition of assets and liabilities has not always provided a “fair presentation” of an entity’s financial position because of the use of different hurdles such as “virtually certain” versus “more likely than not”. |
| | **Question 18** | **Do you support the use of the same criteria for derecognition as for initial recognition?** |
| | | The criteria for derecognition should be the opposite of the requirements for recognition to ensure that accounting symmetry is achieved. This will ensure that the same assets and liabilities are not reflected on more than one government or entity’s financial statements. |
| | **Question 19** | **Should the recognition criteria be an integral part of the element definitions, or separate and distinct requirements?** |
| | | See the response to SMC 17 above. |