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Our ref KK/288
Contact Katja van der Kuij

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Dear Ms Fox

Conceptual Framework Exposure Draft 2 for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements

We appreciate the opportunity to respond to the International Public Sector Accounting Standards Board's ('IPSASB' or the 'Board') Exposure Draft ('ED') entitled *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements*, dated November 2012. We have consulted with, and this letter represents the views of, the KPMG network.

We have considered the specific matters for comments in the ED. We have specific concerns on some of the elements which would result in us not supporting all of the proposals in the ED. These follow below:

Specific Matter for Comment 1

You ask whether *"we agree with the definition of an asset and if not, how we would modify it"*

We generally agree with the definition of an asset; however we would be more specific with regard to the economic benefits and service potential and include the term "**future** inflows of economic benefits or service potential." In addition the term "ability to provide" does not necessarily convey the **expectation** of the future inflows of cash or other economic benefits to the entity. It may be argued that it is not sufficient for an asset to only have the ability to provide future inflows of cash or other benefits but that the future inflows are actually expected to flow to the enterprise.

We further recommend that the ED explicitly state that legal ownership is not an essential prerequisite for recognition of an asset.

Specific Matter for Comment 2

You ask whether *"we agree with the definition of a liability and the definition of non-legal binding obligations and if not, how would you modify it"*

We generally agree with the definition of a liability. We note that the definition does not indicate when the outflow of service potential or economic benefits from the entity will occur. We would consider adding "**on settlement of the present obligation**" at the end of the definition.

We agree with the definition of non-legal binding obligations. We acknowledge the essential need to determine the point at which a non-legal obligation becomes binding and gives rise to a liability. In practice it is likely that public sector entities will have to actively review and monitor delivery against legislated commitments to identify non-legal binding obligations.

We note however, that the terms legal versus non-legal could be interpreted differently in practice. We therefore recommend using other terms for example, stating that the obligation occurred as a result of a contract or as a result of the government acknowledging its responsibility to compensate the public for a particular damage (for example, damage because of a hurricane). The government may not be responsible for this but elected to support the affected community by compensating the citizens for part of their losses. One could argue that the government, in acknowledging that it will pay out compensating damages for this type of event, it became a legal obligation).

We also note that definitions relating to non-legally binding obligations should not be too restrictive at the framework level and further clarification/refinement be provided at a standards level.

Furthermore, we note that paragraph 3.12 is taking a view as to what a liability is, but is actually in principle indicating when a liability should be recognised, not when it exists.

We do not agree with the reasons put forth for not referring to stand ready performance obligations - if the issue is the definition is too broad, then we suggest this be refined at a standard level.

Specific Matter for Comment 3

You ask whether *"we agree with the definition of revenue and if not how would we modify it."*

The current definition of revenue in the conceptual framework refers to "inflows" which increase the "net assets of an entity."

We note that the definition refers to inflows versus "**gross inflows**" as set out in the IPSAS on Revenue. The revenue definition in the relevant standard and the revenue definition in the conceptual framework would appear to be inconsistent. We recommend that inflows in the conceptual framework be amended to "**gross inflows**."

Specific Matter for Comment 4

You ask whether *"we agree with the definition of expenses and if not, how would you modify it"*

The current definition of expenses in the conceptual framework refers to "outflows" which "decrease the net assets of an entity". We recommend that the definition expand on the nature of outflows **(decrease in economic benefits or service potential)** and also should explicitly consider whether consumption of assets/incurrence of liabilities can be added to the definition as this is not explicitly mentioned as follows:

"Expenses are

(a) Outflows during the current reporting period which decrease the economic benefits or service potential during the current reporting period in the form of outflows or consumption of assets or incurrence of liabilities ~~net assets of an entity~~, other than: ......

(b) ......"

Specific Matter for Comment 5

You ask whether *"we agree with the decision to define deferred inflows and deferred outflows as elements and if we do whether we agree to restrict those definitions to non-exchange transactions"*

The introduction to the ED (Paragraph 1.2) states that "Elements are the building blocks from which financial statements are constructed in a way that provides users with information that meets the objectives of financial reporting [accountability and decision making] and contributes to the qualitative characteristics [relevance, faithful representation, comparability, verifiability, timeliness and understandability] of financial reporting."

The distinguishing of inflows and outflows specified for consumption or use in a future reporting period may support decision making and accountability in the public sector. We believe this distinction may also assist in measuring performance of the entity especially for public entities that have a direct service delivery mandate.

We however note that we have specific concerns of defining these deferred inflows and deferred outflows as specific elements. In our view, the intention of the IPSASB is to distinguish "pre-payments" from other assets and liabilities. For example, a deferred outflow can be interpreted as a prepaid expense. We do not believe that this intention has been achieved and there is need for further distinction and clarification. Some of the concerns may be more appropriately addressed at the standards level rather than at the conceptual framework level. Accordingly, we suggest there needs to be more examples from the IPSASB of relevant transactions and the accounting and reporting of those transactions if these elements are to remain in the conceptual framework.

In the definition of a deferred outflow, we would consider replacing the term "provided" to "committed" as follows:

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

We are concerned with establishing a "non-exchange transaction" as a key distinguishing feature when the term is not defined in the framework. If its use continues in its current form then non-exchange transactions should be defined and clarified in the framework. We also note that in some countries, for example, Australia, the Australian Accounting Standards board, as part of an ongoing project "income from transactions for not-for-profit entities", are moving away from the non-exchange transaction concept. The move is in line with the Revenue from Contracts from Customers' exposure draft issued by the IASB i.e. whether a performance obligation exists, which determines whether you get to recognise revenue and effectively a liability to perform, as a result this approach does not distinguish on the nature of transactions but the substance of what the transaction is. Having said this however, we do acknowledge that there are differences across the countries and some of the concepts may already be in existence which could lead to differing views.

Specific Matter for Comment 6

You ask whether *"we agree with the term net assets and net financial position and the definitions"*

We agree with the need to distinguish between net assets (difference between assets and liabilities) and the assets and liabilities after deducting deferred inflows and adding deferred outflows. We however believe that the current term "net financial position" may seem ambiguous and lack clarity for users of the financial statements. Deferred inflows and deferred outflows when meeting the recognition criteria will be classified under liabilities and assets on the face of the statement of financial position. All items recognised on the statement of financial position make up the "net assets" of the entity and to further distinguish these "net assets" into "net financial position" may be confusing or not provide usefulness in this case. Further clarity of how these would practically be distinguished on the statement of financial position is required.

You ask whether "we agree with the decision to define ownership contributions and ownership distributions as elements and whether we agree with these definitions"

We agree with the decision to define ownership contributions and ownership distributions as elements.

The definition of ownership contributions states that they are "inflows of resources to an entity". We would consider expanding on the nature of inflows as future economic benefits or service potential that have been contributed to the entity. Likewise the definition of ownership distribution should expand the "outflows" to "outflows of future economic benefits or service potential".

Paragraph 6.7 relating to ownership contributions may be expanded to highlight that the contributions that give a right/ **entitlement** to a return or increased return to owners…**can be sold, exchanged, transferred or redeemed at the discretion of the owners or their representatives.**

We also note, based on our experience, having distributions and contributions to owners confined to those that establish or increase an interest is not all encompassing, as transfers into an entity which has an ownership structure of shares does not necessarily increase ownership interest percentage but should also not be recognised as revenue.

You ask whether "we think that Ownership interests should be defined in this Conceptual Framework?"

Ownership interest should be defined in this conceptual framework due to the transfer of assets and liabilities/operations that happen within the Public sector. It is necessary to clearly outline and clarify the differences between ownership interest, contributions and distributions.

Specific Matter for Comment 7

You ask whether *"we agree with the discussion on recognition and if not, how would we modify it"*

We agree with the discussion on recognition. Recognition is a separate process after a transaction or other event has met the definition of an element.

KPMG appreciates the opportunity to respond to this Exposure Draft. Please contact Archie Johnston at +1 604 527 3757, Peter Greenwood at +1 604 691 3187 or Katja Van Der Kuij at +44 20 7311 8871, if you wish to discuss any of the issues in this letter.

Yours sincerely

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