IPSAS ED 2 Conceptual Framework ...: Elements and Recognition in Financial Statements

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Introduction

The following comments and suggestions are meant to improve if possible IPSAS ED 2. It is not the intention to provide a complete set of remarks based on a thorough examination of this IPSAS ED 2. Probably there are still other suggestions or comments possible.

General remarks

- The conceptual framework should be established based on user-need accounting research. The current ED's are set up in an imposing way, without preceding user orientedness.

- The ED lacks a number of examples, which can improve their readability and understandability.

Specific remarks

Specific matter for Comment 1: definition of an asset

The definition included in 2.1 on p. 10 can seriously be criticized.

The former definition by IPSAS (IPSAS 2001, IPSAS standard 17) started from the IAS/IFRS definition but replaces the term "enterprise" by "entity" and adds the term "service potential", so that the definition is broadened: *"Assets are resources, (2) controlled by an entity, (3) as a result of past events and (4) from which future economic benefits or service potential are expected to flow to the entity."*(numbers and italics added)

Referring to Christiaens, Rommel, Barton and Everaert (2012) and see also Barton 2004, Christiaens 2004, the economic benefits or service potential of many governmental capital goods **do NOT flow to the entity**, but to the citizens and users. Examples are monuments, landscapes, public roads, heritage assets, collections, etc. Therefore, those governmental capital goods cannot be recognized as being assets. They should be reported off balance sheet.

Apparently, the current ED 2 avoids the problem of to where the benefits and service potential flows, but it should be made clear that those benefits need to flow to the controlling entity in order to recognize capital goods as assets!

Specific matter for Comment 2: definition of a liability

(a) No further remarks

(b) The approach and definition of the so-called non-legal binding obligations is very complex and less transparent. This section needs to be clarified at least by including a few practical examples

Specific matter for Comment 3: definition of revenue

The definition disclosed in section 4.1 on p. 15 is not expressed in terms of a principle or a reasoning , it is just the increase of the net assets of an entity with 2 exceptions.

Net assets can change in terms of capital movements (e.g. long term financing by donors, merger with another government, long term financing by IMF, funding by another government, etc.) next to changes caused by the operational activities resulting in revenues or expenses. It is the aim of a income statement (P/L account) to provide the stakeholder with a detailed overview of the different revenues and expenses explaining the operational movement of the net assets.

In other words revenues and expenses should be defined as the result of the operational changes in the net assets, not vice versa.

Specific matter for Comment 4: definition of expenses

See revenues

Specific matter for Comment 5: definition of deferred inflows and deferred outflows

(a) The definition of **deferred inflows** is indeed necessary to enable the accounting for e.g. received funds that will be spend by the government in later periods. In the accounting regulations of the **American GASB** rules this is called net assets of the kind *"Permanently restricted funds"* or *"Temporarily restricted funds"*. Hence, these means of financing are "earmarked" and should not be expensed for other kinds of purposes than the purposes foreseen in the funding contract.
The IPSASB should not develop complex terms to capture this kind of governemtal activity in the light of IFRS, IPSASB could analyse more thoroughly the American GASB rules.
Regarding **deferred outflows** the exposure draft an important question still remains: let us take the same example as described in 5.4 on p. 16: a multi-year grant is transferred by an entity with the stipulation by the transferor that it is to be used over one or more future reporting periods: in case this amount will be accounted for as an

immediate decrease of the transferor's net assets preferably disclosed as a separate element, the accounting policy can be approved. However, deferred outflows should never be disclosed positively on the asset side of the balance sheet! For a period in the nineties in Belgium municipalities had to account for deferred outflows as assets, meanwhile this incorrect approach has been abandoned.

The approach of deferred inflows and deferred outflows should also keep in mind that governments can acquired funds on behalf of somebody else like a "legacy" or acquired as an agent just for logistics and distributions: e.g. nutrition aid in Africa: certain governments and non-profit organisations are asked to take care of the distribution of food, health care instruments, etc. for poor people. The organisations acquire therefore gifts and donations without any economic reason but just for cultural and human reasons. They become to some extent 'proprietor' of the goods and the resources, but only temporarily and somehow in terms of an agent who is supposed to take care of the distribution and the logistics.

(b) (i) It is obvious that governments are used to play an important role in the so-called deferred inflows and deferred outflows and this mostly in the perspective of non-exchange transactions. The ED can restrict those definitions to non-exchange transactions, because for exchange transactions the accrual adjustments have already been foreseen by taking over the IAS/IFRS principles where exchange transactions with deferred inflows are known
(ii) See American GASB approach above

Specific matter for Comment 6

(a) No remarks

(b) Ownership contributions and ownership distributions: the decision to define these terms can be questioned: to establish or to increase or decrease an interest in the net assets of a government appears to be a contradiction: in the public sector there are no shares, nor stockholders; the net assets represent long term financing without any rights for shareholders
Of course it might be possible that certain governmental activities are organised by a corporate organisations having shares, e.g. a bank owned by the central government, a railroad company of which the government has the majority of the shares, etc. However, such corporations are no governments and follow business accounting standards such as IFRS

(c) N/A

(d) N/A

Specific matter for Comment 7: discussion on recognition

This section should be examined scientifically by specialists in terms of “accounting theory”.

References

International Public Sector Accounting Standards Board (IPSASB), *Glossary of Defined Terms*, *IPSAS 1 to IPSAS 12*, 2001.

International Public Sector Accounting Standards Board (IPSASB), ‘*Property, plant and equipment’*, International Public Sector Accounting Standard No. 17, 2001

Christiaens J., Rommel J., Barton A., Everaert P. (2012), Should All Capital Goods of Governments be Recognised as Assets in Financial Accounting?, *Baltic Journal of Management*, Vol. 7(4), p. 429-443.

Barton, A. D. (2004), How to profit from defence: a study in the misapplication of business accounting to the public sector in Australia, *Financial Accountability & Management*, 20(3), pp. 281-304.

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