

# LIMITED SCOPE UPDATE OF CONCEPTUAL FRAMEWORK

## PROJECT BRIEF AND OUTLINE

### 1. Introduction

- 1.1. [The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities](#) (the Framework) was approved in September 2014 and issued in October 2014. A [webinar](#) was issued early in 2015. Publication of the Framework filled a major gap in the IPSASB's literature. Until 2014 the IPSASB had been implicitly reliant on the former International Accounting Standards Committee's (IASC) *Framework for the Preparation and Presentation of Financial Statements*, which was published in 1989. The International Accounting Standards Board (IASB) adopted this document shortly after its inception in April 2001.
- 1.2. On approval in September 2014 the IPSASB decided not to commit to a review of the Framework. Although views were expressed that the Framework should be a 'living document' subject to regular updates there was a broader view that it should be allowed to bed down for a significant period. The decision also reflected the amount of Board time devoted to the Framework, particularly in the four to five years prior to approval and, to a lesser extent, that over-frequent updates might diminish the accountability of the Board, which the Framework is supposed to promote.
- 1.3. In 2018, after having been applied in standards development for over three years the IPSASB considered that a limited scope review of the Framework would be appropriate. This view was reinforced by the fact that the IASB was shortly to issue its finalized Conceptual Framework reflecting post-2014 developments of potential significance. The IPSASB therefore proposed such a project in its Strategy and Work Plan Consultation in 2018. The proposed project received significant support from respondents for the reasons outlined by the IPSASB and is one of two projects that the IPSASB committed to initiate in the 2019-2020 period.
- 1.4. Participants at the June 2019 Public Sector Standard Setters Forum (Forum) in Niagara-on-the-Lake, Canada, discussed the committed project to provide input and views on the issues that should be within scope. Although the Forum attendees confirmed support for their addition to the work program. there were significant differences of opinion as to which issues should be addressed in the Framework review.
- 1.5. The Consultative Advisory Group (CAG) discussed the project at its meeting in Abu Dhabi in December 2019. Staff presented [a paper](#) with the drivers for the project and the classification of potential issues as Urgent, Significant and Less Significant. CAG members supported both the drivers (see below) and, in general, the classification of issues. A number of CAG members also raised the prospect of reputational risk if IPSAS is not aligned with the Framework. Although not explicitly discussed staff note that the approach to recognition in Chapter 6 of the Framework has not been reflected at standards level. Key Issue #5, which was not explicitly discussed with the CAG, has been included in the project brief following consideration of responses to the Consultation Paper, *Measurement*. However, it is a fair value-related issue and therefore responds to the concerns expressed by CAG members.

## 2. Rationale for Project

- 2.1. As noted above, the project was added to the IPSASB's work program after consultation with constituents on the Strategy and Work Plan 2019-2023. There are two project drivers:
- (a) Certain developments in the International Accounting Standards Board's (IASB's) revision of its Conceptual Framework after September 2014.
  - (b) Experience in using the Conceptual Framework in developing new pronouncements and maintaining existing IPSAS since approval in September 2014.

## 3. Financial Reporting Requirements

- 3.1 The Framework establishes the concepts that are to be applied in developing IPSAS and Recommended Practice Guidelines (RPGs). RPGs provide guidance on financial reporting issues outside the core financial statements. The Framework is non-authoritative and does not override requirements in IPSAS. Nevertheless, the Framework underpins standards development and the IPSASB will explain reasons for departure from the Framework in the Bases for Conclusions of particular pronouncements. The project has links to the Measurement project. It is important that the project progresses in step with the Measurement project and that the ED of proposed amendments to the Measurement Chapter of the Framework is issued at the same time as ED XX, *Measurement*.

## 4. Project Objective

- 4.1 The project objective is to update the Conceptual Framework for a limited number of issues based on the criteria of urgency, consequences, feasibility, and prevalence with a particular emphasis on the first three of these criteria.

### Achieving the Objective

- 4.2 In view of the limited scope of the project, the view is that a Consultation Paper is unnecessary, and given the short project timelines a Task Force will not be formed. A Board Member Sponsor will be appointed. There will be a strong linkage with the Measurement Task Force, and also, to a lesser extent, the Task Forces on Heritage and Infrastructure. Staff involved in the project will participate in the in-person Measurement Task Force meeting planned for July 2020 if this goes ahead.
- 4.3 To achieve the objective the IPSASB will:
- Determine an appropriate and manageable scope for the project by applying the criteria for project prioritization in the Strategy and Work Plan 2019-2023, particularly urgency, consequences and feasibility;
  - Consider the links to other projects (the Measurement project); and
  - Formulate a communications plan to manage external expectation, particularly explaining that the Update is not a full -scale review of the Framework.

### *Link to the IPSASB's Strategic Objective*

- 4.4 The IPSASB's Strategy and Work Plan 2019-2023 *Delivering Global Standards. Inspiring Implementation*, cites an overarching strategic objective as:

**Strengthening Public Financial Management (PFM) globally through increasing adoption of accrual-based IPSAS.**

Delivered through two main areas of activity, both of which have a public interest focus:

- Developing and maintaining IPSAS and other high-quality public sector financial reporting guidance for the public sector; and
- Raising awareness of the IPSAS and the benefits of their adoption.”

4.5 This project is consistent with the IPSASB’s strategic objective because the Framework underpins the development and maintenance of IPSAS and RPGs. The project has a pervasive impact on Themes A-C of IPSASB’s current Strategy.

## **5 Outline of the Project**

### **Project Scope**

5.1 The scope of this project is to update the Conceptual Framework in specified areas. Key Issue #1 explains the scope. The key issues will be addressed in two phases: Key Issues #1-#6 are in Phase 1 while Key Issues #7-#10 are in Phase 2. A decision on the appropriate number of Exposure Drafts and timing of publication will be made in the context of expected staff / Board time, progress, and need to coordinate with Measurement-related project package and constituent focus / workload

### **Key Issues**

#### *Key Issue # 1—Scope*

5.2 The project is limited in its scope as indicated by its title. It is not a full review of the Framework and does not address all issues or potential issues related to the Framework. The development of the Framework took a large proportion of meeting agenda time in the 2006-2014 period and it is important that other projects on the work program are not ‘crowded out’ by the Framework. Therefore, the focus is largely, but not fully, on issues which, if not addressed, are likely to mean that the Framework will be misaligned with the outputs from the Measurement project, and on issues that will lead to misalignment with IASB literature for no public sector reason.

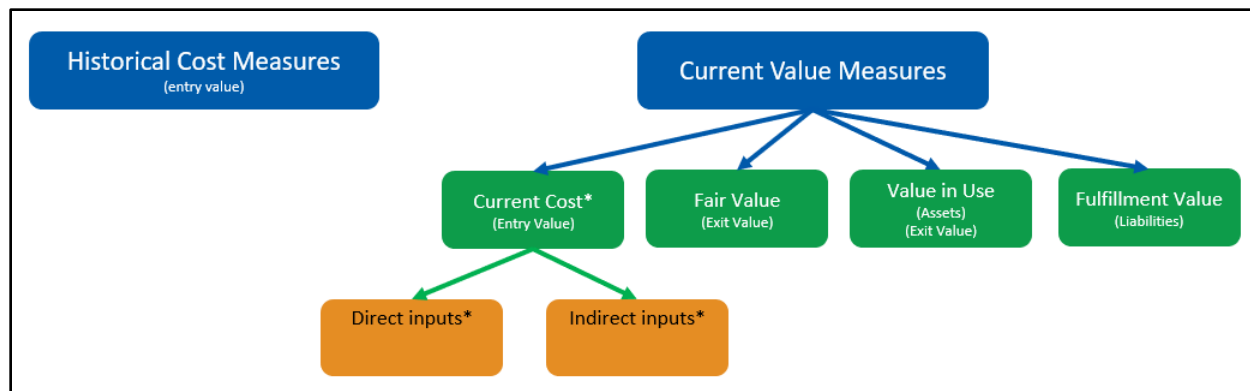
#### *Key Issue # 2—Impact of revised IASB Measurement Chapter*

5.3 The finalized IASB Measurement chapter was restructured from that outlined in the IASB’s 2013 Discussion Paper. This new structure brought the IASB approach closer to IPSASB, although there are important differences. Unlike the IASB Framework, the IPSASB Framework explicitly includes a measurement objective linked to the provision of information on operational capacity, financial capacity, and the cost of services, whereas the IASB Framework has a section on ‘Factors to Consider When Selecting a Measurement Basis.’

5.4 The IASB Framework distinguishes historical cost measures and current value measures. Current value measures discussed are fair value, value in use for assets and fulfilment value for liabilities all of which are exit values and current cost for an asset, which is an entry value. This approach will be compared with the current version of the IPSASB’s Framework, which includes measurement bases that are not included in the IASB’s Framework – net selling price for assets and assumption price and cost of release for liabilities. The IPSASB Framework has used the term ‘cost of fulfillment; rather than ‘fulfillment value’, the term adopted by IASB. The project will consider whether there are any unforeseen consequences of adopting the term ‘fulfillment value’. The update will consider whether

there are any substantive differences between the two measures, and, if not, whether IPSASB should adopt the same term as the IASB. The IASB approach is illustrated in Diagram 1.

*Diagram 1: IASB Approach to Historical Cost and Current Value Measures*



- 5.5 The IASB Framework also includes sections on the measurement of equity and cash-flow based measurement techniques, neither of which were considered in the IPSASB Framework. Fair value is considered at Key Issue # 3.
- 5.6 The project will consider whether the IPSASB should modify its Measurement Chapter in light of the IASB's approach.

#### Key Issue # 3—Absence of fair value from IPSASB Framework

- 5.7 IFRS 13, *Fair Value Measurement*, was issued in 2011. It introduced a revised definition of fair value that is explicitly exit-based. As indicated above fair value is one of the measurement bases included in the IASB Framework with the same definition as in IFRS 13.<sup>1</sup> In its Conceptual Framework Exposure Draft (ED) on Measurement issued in 2013 IPSASB did not propose a fair value measure. A number of respondents challenged the lack of an exit-based market derived current value and advocated adoption of fair value, as defined in IFRS 13<sup>2</sup>.
- 5.8 Despite these reservations the IPSASB decided to define 'market value'<sup>3</sup> using the pre-IFRS 13 definition of fair value as used in IPSASB literature, and also to define replacement cost as a measure in its own right, rather than as an estimation technique for fair value. The rationale was that market value could be used for both entry and exit-based transactions and that replacement cost would be appropriate for specialized public sector assets. Recently, the Financial Instruments project and the Measurement project have demonstrated the need for an exist-based non-entity specific current value reflecting an open, orderly and active market.
- 5.9 The Basis for Conclusions of the Framework stated that "The IPSASB may carry out further work at standards level to explain how the measurement basis in this chapter aligns with fair value, as implemented in IFRS." Consistent with this statement, in 2019 the [Consultation Paper, Measurement](#) proposed importing fair value as defined in IFRS 13 into the IPSASB literature. CAG members have emphasized that, from a public interest perspective, it is very important that any fair value definition

<sup>1</sup> Fair value is the price that would be received to sell an asset or paid to transfer a liability between market participants at the measurement date.

<sup>2</sup> The IASB completed a post-implementation review of IFRS 13 in 2018 and concluded that IFRS 13 is working as intended. .

<sup>3</sup> Market value for assets is the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction

in the IPSASB's literature is the same as the IFRS 13 definition. A number of respondents to the Measurement Consultation Paper highlighted the numerous references to fair value in IPSAS and sought clarification. Furthermore, it is essential that the Measurement project and the Conceptual Framework move in step on this issue. For these reasons the inclusion of fair value in the Framework is an urgent issue.

- 5.10 The issue of when to apply 'highest and best use' in the context of fair value is a standards-level issue and will be addressed in the Measurement project rather than in this project.

*Key Issue # 4—Relationship between fair value and market value*

- 5.11 The relationship between fair value and market value must be clarified. As implied above, the rationale for the inclusion of market value in the Framework is that, as an entry and exit value, it is an appropriate measurement basis for non-specialized operational assets. This could have been stated more clearly. There are questions whether both market value and fair value are needed in IPSASB's literature and the practical consequences of having two similar measurement bases.

*Key Issue # 5—Tension between replacement cost as a measurement basis and replacement cost as an estimation technique for fair value*

- 5.12 A number of respondents to the Measurement Consultation paper highlighted tension between the proposal that replacement cost as an estimation technique in the determination of fair value in accordance with IFRS 13 and the Conceptual Framework's depiction of replacement cost as a measurement basis in its own right. This issue needs to be investigated in order to ascertain whether replacement cost should be retained or modified or whether there should be changes of terminology. The issue of asset specialization, which is linked to the selection of replacement cost as an appropriate measurement basis, will be considered in the Measurement project rather than in this project,

*Key Issue # 6—Concepts of capital and capital maintenance*

- 5.13 As noted above, unlike the IASB Conceptual Framework, the chapter on Measurement includes an objective of measurement:

*"To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account and for decision-making purposes."*

- 5.14 When the Framework was developed, it was considered that in light of this objective a section on concepts of capital and capital maintenance was unnecessary and, furthermore, that the chapter in the IASB Framework, which dates back to the IASC's 1989 Framework, was not easily oriented to the public sector. Recent discussion of financial performance in the public sector has suggested that this view should be reassessed, because capital maintenance is fundamental to assessments of financial performance. It was also proposed as relevant in the 2019 IPSASB Measurement Consultation Paper.

*Key Issue # 7—Elements: Definitions of an asset and a liability*

- 5.15 The IPSASB Framework defines an asset, a liability, revenue, expense, contributions from owners and contributions to owners. The IASB Framework defines an asset, a liability, equity, income, and expenses.

- 5.16 The IASB finalized these definitions after the approval of the IPSASB Framework. Staff's preliminary view is that the differences between the definitions of an asset and a liability in the two Frameworks are not substantive. However, it is important that this view is tested for consequences that are not immediately apparent, e.g., does a present obligation of the entity for an outflow of resources (IPSASB) differ from a present obligation of the entity to transfer an economic resource (IASB) (staff underlining for emphasis). The difference in the definitions of income (IASB) and revenue (IPSASB) and expenses (IASB) and expense (IPSASB) are attributable to IPSASB's acknowledgement of other economic phenomena –other resources and other obligations. It is not proposed that the issue of the continued retention of other resources and other obligations is in scope of this project. The project will not consider the need for further elements to the six currently defined

*Key Issue # 8—Unit of account and executory contracts*

- 5.17 Although not new developments as they reaffirmed previous approaches the finalized IASB Framework included subsections on unit of account and executory contracts.
- 5.18 The IPSASB Conceptual Framework does not include equivalent sections. Unit of account is 'the right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations, to which recognition criteria and management concepts apply'. Unit of account was considered a standards-level issue during the development of the IPSASB Framework and there were reservations about including a section on it. However, the importance of decisions on the unit of account has been highlighted in both the Financial Instruments and Revenue projects and there is certainly a case for some high-level guidance. The development of such guidance will consider whether there are any public sector perspectives that need to be reflected.
- 5.19 Similarly, the IPSASB Framework does not include any guidance on executory contracts. This was because of a view that inclusion might have had unforeseen consequences for the Social Benefits project. With the publication of IPSAS 42, *Social Benefits*, earlier this year and the approval of the *Application Guidance on Collective and Individual Services* at the September 2020 meeting this risk no longer exists and the case for high-level conceptual guidance on executory contracts will be considered.

*Key Issue # 9—Acknowledgement of prudence in context of neutrality*

- 5.20 The core text of the IPSASB Framework does not refer to prudence. Paragraph BC3.15 of the Basis for Conclusions notes that some respondents to the Framework ED on *Role and Authority, Objectives, Qualitative Characteristics and the Reporting Entity*, had expressed concern that prudence was not identified as a qualitative characteristic (QC) and felt that its importance was insufficiently recognized or explained. The IPSASB concluded that 'prudence is reflected in the explanation of neutrality as a component of faithful representation .....(and) therefore....prudence is not identified as a separate QC because its intent and influence in identifying information that is included in GPFRs<sup>4</sup> is already embedded in the notion of faithful representation.'
- 5.21 Following representations from constituents, in particular from Europe, and considerable discussion, the IASB Framework acknowledges that 'neutrality is supported by the exercise of prudence' and that 'prudence is the exercise of caution when making judgments under conditions of uncertainty.' The IASB Framework goes on to state that 'the exercise of prudence does not lead to overstatements or understatements of assets, liabilities, income or expense. Furthermore, the exercise of prudence

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<sup>4</sup> General Purpose Financial Reports

does not imply the need for asymmetry, although particular standards may contain asymmetric requirements.

- 5.22 The staff view is that the consequences of these changes are not particularly far-reaching. Nevertheless, there are strongly held views on prudence. For example, prudence has been emphasized by a number of members of the European Public Sector Accounting Standards (EPSAS) Working Group. A failure to address prudence may therefore be a deterrent to IPSAS adoption in some regions. The project will therefore address the issue of prudence.

#### Key Issue # 10—Materiality

- 5.23 The IASB's 2018 Improvements Project made amendments to IAS 1, *Presentation of Financial Statements*, and IAS 8, *Accounting Policies, Changes Accounting Estimates and Errors*, to clarify the definition of material in order to resolve difficulties that entities experience in making materiality judgements when preparing financial statements and to align the definitions in both standards. Because of these changes the IASB also amended Chapter 2 of its Framework. One aspect of these changes is guidance that immaterial disclosures have the potential to impair the understandability of the financial statements, rather than just being neutral. Staff considers this an extremely important insight.
- 5.24 At the June meeting the IPSASB considered including the standards-level amendments in its 2019 Improvements project but decided that they should be initially considered in this project. In Staff's view there is some urgency to this issue from both an alignment perspective and because materiality is a pervasive issue in the public sector.

#### Key Issue #11—Communication

- 5.25 As with other IPSASB projects there is currently an active external stakeholder community with expectations for this project. As a result, it will be important to manage expectations with formal and regular communications which reinforce the objective of this project, particularly its limited scope.

## 6 Describe the Implications for any Specific Persons or Groups

### Relationship to IASB

- 6.1 In March 2018, the IASB published its *Conceptual Framework for Financial Reporting*. This built on the April 2010 version which took the IASC's 1989 Framework as its starting point.
- 6.2 Subsequent to the publication of the Framework the IASB made some limited scope amendments to Chapter 2, *Qualitative Characteristics of Useful Financial Information*, relating to materiality (see above Key Issue #10).

### Relationship to Other Standards, Projects in Process or Planned Projects

- 6.3 Because of its central role in standard setting and the development of guidance on financial reporting issues outside the financial statements the Framework has a major impact on all current and prospective projects. There is a particularly strong relationship with the Measurement, Heritage and Infrastructure projects and the proposed project on Accounting for Non-Current Assets Held for Sale and Disclosures on Discontinued Operations in the Public Sector, the project brief for which is projected to be approved in June 2020.p).

## Government Finance Statistics

- 6.4 The concepts in the Framework affect the IPSASB's analysis of approaches in the Government Finance Statistics Manual and how the IPSASB applies its [Process for Considering GFS Reporting Guidelines during Development of IPSAS](#).

## 7 Development Process, Project Timetable and Project Output

### Development Process

- 7.1 The development of any output will be subject to the IPSASB's formal due process, with input from CAG. The approval of an ED(s) will be subject to the usual IPSASB voting rules. As the project progresses, regular assessments will be made to confirm that the project timetable remains the most appropriate. The IPSASB will assess the appropriate number of EDs and timing of publication, in the context of expected staff and Board time, progress on the project, the need to coordinate with the Measurement-related project package and constituent focus and workload considerations.

### Project Timetable

- 7.2 The expected timeline for the project is below. As indicated above, this may change dependent on decisions on the number of EDs. The timeline below reflects

Major Project Milestones–	Expected Completion
Approve Project Brief	March 2020
Approve Exposure Draft (ED)	December 2020
ED Comment Period <sup>5</sup>	July 2021
Review of Responses to ED	December 2021 & March 2022
Discussion with Consultative Advisory Group	December 2021
Approve Final Revisions to Framework	June 2022

### Project Output

- 7.3 The output will be revised parts of the Conceptual Framework, in particular Chapter 7, Measurement. There will also be amendments to Chapter 3, *Qualitative Characteristics and Constraints of Financial Reporting* and Chapter 5, *Elements*. There will be a decision on whether material on concepts of capital and capital maintenance will be incorporated into Chapter 7 or a separate chapter, as in the IASB Framework.

## 8 Resources Required

### Staff

- 8.1 It is envisaged that 0.5 Full Time Equivalent (FTE) staff member will be required to resource the project.

<sup>5</sup> The Timeline assumes a six-month consultation period to align with the consultation period for ED, *Measurement*



## **Factors that Might Add to Complexity and Length**

8.2 Factors that may add to the add to the complexity and length of this project include:

- (a) Broadening the scope beyond that indicated in the project brief;
- (b) External expectations for this project, which leads to the need for more robust communication with constituents; and
- (c) Coordination and consultation required with Measurement Task Force and the Task Forces on Heritage and Infrastructure.

## **9 Useful Sources of Information**

9.1 The principal source will be the IASB's Framework.