ERNST & YOUNG

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft
Mittlerer Pfad 15
70499 Stuttgart
Postfach 31 16 20
70476 Stuttgart
www.de.ey.com

Thomas Mueller-Marqués Berger/spf
Phone +49 711 9881 15844
Fax +49 711 9881 17856
thomas.mueller-marques.berger@de.ey.com

15 June 2011

Ms Stephenie Fox
Technical Director of the
International Public Sector Accounting
Standards Board (IPSASB)
International Federation of Accountants
277 Wellington Street West
Toronto Ontario M5V 3H2
CANADA

IPSASB Consultation Paper: Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements

Dear Ms Fox,

The global organization of Ernst & Young is pleased to comment on the above Consultation Paper.

General comments

First, we wish to emphasize that IPSASB's Conceptual Framework Project is a milestone in public sector accounting and that the subproject "Elements and Recognition in Financial Statements" is of great theoretical and practical importance. In our opinion the board has asked the right key questions in this consultation paper.

As a global audit firm, we have asked ourselves these questions in particular, also from the perspective of an auditor. In our opinion, accountability is also a question of practical feasibility. From this consideration follows that practical feasibility is a necessary condition for high quality accounting standards.

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Specific Matters for Comment

Assets

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?

We support a broad definition of an asset. Therefore the definition of an asset should cover "service potential" and "net cash inflows".

We feel that the definition of an asset should not cover "unconditional rights to receive resources" because of the difficulty of defining this concept. However we acknowledge that information about material "unconditional rights to receive resources" may be relevant for users. Against this background we would recommend a disclosure in the notes.

The term that we would like to see in the definition of an asset is "economic benefits and service potential". We believe that this illustrates the differences between public sector accounting and private sector accounting the best.

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?

There is no clear delimitation between the theoretical approaches. Therefore it is difficult to make a distinction between the approaches in practical implementation. Given the fact that private sector standard setters are considering moving away from the use of the term "control" in determining rights to benefit, we suggest monitoring the current developments. We do not see any public sector specific reasons that justify a deviation from private sector developments.

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We support the concept of economic ownership. In our view economic ownership requires an enforceable claim to benefits or an ability to deny, restrict, or otherwise regulate access by others. Additional requirements to establish a link between the entity and an asset are not necessary.

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?

From an auditor's view we welcome objective accounting guidelines. If a past event needs to have occurred, the existence of an asset is more easily verifiable on an intersubjective basis. This is the reason why we support the view that a past event must have occured.

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?

From an auditor's view we welcome an objective guideline. In our view accountability is also a question of practical feasibility. We expect that the measurement of public sector entity rights and powers is not verifiable intersubjectively and would be subject to large fluctuations in value. This is the reason why we support the view that public sector entity rights and powers, such as the power to tax and levy fees, are only assets when those powers are exercised.

We appreciate, however, that the appropriate information is helpful for the users. Against this background such public sector entity rights and powers should be presented and measured (by way of an estimate) in the notes or in other reports such as a long-term fiscal sustainability report.

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?

No further comments.

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Liabilities

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?

We believe that the definition of a liability should cover "obligations to transfer benefits", "unconditional obligations" and "performance obligations". However, we would welcome it if you were to focus on specific matter for comment 8 and our opinion that there is always the need for a past event to have occurred. Applying the same logic, "unconditional obligations to stand ready to insure against loss (risk protection)" cannot be considered as liabilities. With regard to the asset definition, we believe that this is a well balanced definition (see specific matter for comment 1).

In our opinion, the definition of a liability should also cover "obligations to provide access to or forego future resources". With regard to the liability definition we assume again that a past event must have occured (see specific matter for comment 8). Under the premise that a performance obligation to provide access to or forego future resources demonstrates the existence of an adequate past event, it is appropriate to define this type of obligation as a liability.

We think that a settlement date is not an essential requirement for a liability. Alternatively, we support the view expressed in paragraph 3.22 that a settlement date with a definition that includes "on the occurrence of a specified future event" might be appropriate too.

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?

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We support the view that the ability to identify a specific party outside the reporting entity to whom the entity is obligated should be part of the supplementary discussion. Identifying a specific party seems to be difficult in many cases, e.g., if there is a greater number of people.

The absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability. In determining whether an entity has a realistic alternative to avoid the obligation we agree that a moral obligation differs in substance from a legal obligation. However, a government has an obligation to fulfill its side of the transaction if a constructive obligation that is not legally enforceable arises from an exchange transaction. Even if the agreement is not legally enforceable, the government has an obligation because of the economic consequences for future exchange transactions if it does not fulfill its agreement. Based on these considerations, we support the second approach.

The third approach, which covers constructive obligations arising from non-exchange transactions, seems to include a very broad liability definition. Valid expectations for the entity to perform may become obsolete after a change in government. From an auditor's view we would assume that such a liability is not verifiable intersubjectively and would be subject to large fluctuations in value. Something else applies only in the rare cases where a past event has occurred (e.g., a request for disbursement of funding). We appreciate, however, that the appropriate information under the third approach is helpful for users. Against this background, such public sector entity rights and powers should be presented and measured (by way of an estimate) in the notes or in other reports such as a long-term fiscal sustainability report. Furthermore we would like to underline the symmetry with the asset definition expressed in the specific matter for comment 4.

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?

We support a balanced asset and liability definition. In accordance with the view expressed regarding the asset definition (see specific matter for comment 3), we consider a past event that has occurred to be necessary.

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?

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The recognition of perpetual obligations as a liability would not require the occurrence of a past transaction or event for the obligation to meet the definition of a liability. As mentioned above (see specific matters for comment 3 and 8) we are in favor of a past event that has occurred with respect to assets and liabilities. Furthermore we would like to stress that perpetual obligations are part of the "ongoing activity" of governments. The existence of a past event that has occurred is the essential difference between "ongoing activities" and an existing liability.

We share the view expressed in paragraph 3.50, which holds that the parties to whom the obligations are made must presently be able to enforce their claims. The approval of the budget alone does not transform plan, policies, and programs into enforceable obligations at the date the budget is approved. With respect to the diagram in paragraph 3.45, which provides a broad overview, an obligation only meets the definition of a liability on the right-hand side of the diagram.

The question raised in paragraph 3.58 is also very pertinent. If stipulations require the return of the transferred benefits in cases where the recipient does not comply with the terms of the agreement, the recipient has a liability related to the transferred assets until it has complied with the terms of the agreement.

The definition of a liability should include an assumption about the role that sovereign power plays. With respect to the sovereign power to avoid obligations we support the approach to base the determination of whether a liability exists on reference to the legal position at the reporting date. A legal position at the reporting date depends on whether the government has made use of its sovereign power at the reporting date.

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?

No further comments.

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Financial Performance: Revenue and Expense

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?

Revenues and expenses should be determined based on changes in net assets, defined as resources and obligations (asset and liability-led approach). As far as we can see, this is the approach predominating at an international level and theoretically convincing.

The asset and liability-led (A&L) approach is theoretically convincing because of the fact that "net assets" has its own meaning and is interpretable only under the A&L approach. Finally, under the R&E approach, the statement of financial position (balance sheet) is reduced to a mere deferral account. At the same time it must be borne in mind that the period net income (whether in the private or public sector) will never be the generally accepted "true" net income for the period, regardless of whether deferred outflows and deferred inflows are defined as separate elements. From a theoretical point of view the generally accepted "true" net income for a period would be the change in the discounted cash flow, which cannot be determined from the balance sheet.

However, the theoretical discussion of the two concepts is futile. In the practical application the two concepts cannot be clearly distinguished. It is striking that in the examples in paragraph 4.16 assets are always accounted for at the same amount in both approaches. Moreover, it has to be stressed that the charm of the double-entry bookkeeping is the systematic link between revenue/expenses and capital account. It follows that both elements are equally essential.

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?

In our view the nature of a transaction indicates whether it should be included or excluded from the revenue and expense definition. A general guideline could be that most of the transactions with holders of a residual/equity interest (e.g., as customer or supplier and as tax payers or grant recipients) should be included as revenues and expenses at government level.

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However, this does not apply for minority interests in consolidated financial statements (see specific matter to comment 15).

The definitions of revenue and expense should not be limited to specific types of activities associated with operations. We support the view that such classifications are issues of financial statement presentation, not of element definition. In our view gains and losses should be included in the definitions of revenue and expense because they are similar in nature, as both sets of items result from increases and decreases in net benefits. The same applies for the distinction between non-exchange and exchange transactions and events, which should only be regulated differently at standard level.

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?
(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?

No further comments.

Other Potential Elements

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?

As mentioned above, we support the asset and liability approach (see specific matter for comment 11). Against this background, we have reservations about the capitalization of deferred outflows in the balance sheet. However, this does not necessarily apply for the recognition of deferred inflows.

The question can only be answered conclusively in the context of the final definition of liabilities. Should other comments favor a need to identify deferred inflows on the statement of financial position, we would support a definition of deferred inflows as a separate element. The definition as set out in paragraph 5.8 seems appropriate and complete.

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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?

Generally we consider net assets/net liabilities to be a residual amount. In contrast to the private sector, governments do not have any shareholders and the characteristics of a citizen are not comparable to those of a shareholder. It follows that the ownership interest approach is not relevant at the government level. With regard to the residual interest approach, it is worth considering it for subsidiaries (e.g., agency operations or semi-autonomous entities created by governments as mentioned in paragraph 5.19).

However, minority or non-controlling interests in consolidated financial statements are different types of capital contributions. Given that fact, we are in favor of incorporating minority or non-controlling interests in the element definition.

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?

We refer to our comments regarding the specific matters for comment 12 and 15. In general we consider net assets/net liabilities as a residual amount. Moreover, most of the transactions with holders of a residual/equity interest should be included as revenues and expenses. We feel that the discussion about that matters for comment should help to provide more clarity in this respect, too.

Recognition

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?

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(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?

How to deal with uncertainty is a question of major importance. Generally we attach importance to the feasibility of guidelines and therefore support a "more likely than not" approach. However, we do not see any public sector specific reasons regarding that issue that would justify deviation from private sector developments. For this reason, we recommend referring to the current developments at the IASB.

However, if the threshold approach were to be chosen, we would support a uniform threshold for both assets and liabilities. This follows from the premise that there should be a balanced asset and liability definition.

Specific Matter for Comment 18: Do you support the use of the same criteria for derecognition as for initial recognition?

In general we support the use of the same criteria for derecognition as for initial recognition.

Specific Matter for Comment 19: Should the recognition criteria be an integral part of the element definitions, or separate and distinct requirements?

In our opinion there should theoretically be a clear distinction between the definition of elements and the recognition criteria as separate issues. It follows that the recognition criteria have to be considered in a second step.

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We would be pleased to discuss our views with the Board or its staff at their convenience. Please contact Thomas Müller-Marqués Berger at +49 711 9881 15844.

Yours faithfully,

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Prof. Dr. Peter Oser

Thomas Müller-Marqués Berger

ØKONOMISTYRELSEN

Memo

30. maj 2011
ØKO/SRH/BJJ

Comments to the Consultation Paper concerning Elements and Recognition in Financial Statements

Below, the comments from the Danish Agency for governmental management are divided into a number of general comments and a number of specific comments regarding the recognition of assets/liabilities and revenues/expenses.

1. General comments

Generally, the Danish Agency for governmental management agrees to the idea about making guidelines for how each item in the accounts should be identified and classified. We also find that all assets and liabilities must be identified.

Although all assets and liabilities must be identified, that does not mean that all assets and liabilities should also be included in the entity's financial Statement.

The decision whether assets and liabilities should be included in the financial statement must be decided on the basis of whether the costs by making a precise and complete measurement commensurate with the benefits associated with such a practices, cf. our comments to the Consultation Paper concerning Measurement of Assets and Liabilities in Financial Statements.

In that light we only use cost based accounting in relation to the running operation of the entity.

In Denmark the purpose of the financial statements of the central government agencies is to support the monitoring and comparison of the performance and application of resources in the institutions. In addition, the Danish accounting requirements supports good business management in the public sector.

The content of financial statements should form the basis for pricing on public services and measurement of the use of appropriations. Hence, only revenue and expenses as well as assets and liabilities are recognised in the financial statements with value, if the items are part of operating activities. Visibility of pricing and the focus on operating activities are the reasons why e.g. donations do not impact the income statement and why heritage assets do no impact the balance sheet with value.

Furthermore we find it important to underline that the recognition of assets and liabilities must be based on definitions which are precise and not to wide as you otherwise risk too use disproportionate many resources in identifying and measuring items which are not relevant in relation to the financial statement.

2. Specific comments concerning elements and recognition of assets and liabilities

The Consultation Paper concerns the following main topics regarding elements and recognition of assets and liabilities:

1. What type of benefits and obligations should assets and liabilities include?

2. Is it sufficient to state that an asset or a liability is a "present" resource, or should there be a past event that occurs and which approach should be used to associate an asset or a liability with a specific entity?

3. Are public sector rights as those associated with the power to tax and levy fees are they assets only when those powers are exercised or is there en intermediate event that is more appropriate – and are public sector entity obligations such as those associated with its duties and responsibilities as a government, perpetual obligations, obligations only when they are claims, or is there an appropriate intermediate event that is more appropriate?

What type of benefits and obligations should assets and liabilities include?

IPSAS paper discusses the definition of assets and liabilities from a resource view and discusses it from 3 different angles.

1. Recognition of assets/liabilities on the basis of matters only concerning the running operation of the entity

2. Recognition of assets/liabilities on the basis of matters also concerning state activities such as early retirement and pension obligations and the right to collect taxes

3. Rrecognition of assets/liabilities from a socio-economic perspective – the general registration framework which includes natural resources, sustainability and so on

According to the Danish model, we only use cost based accounting in relation to the running operation of the entity.

This is partly because the primary purpose of the cost based accounting is to support the ongoing financial management by compiling the resources needed for handling the entity's task. At the same time it is very important to us that the registration support the ability to maintain a tight appropriation control.

In Denmark the early retirement obligations and pension obligations are not included in the financial statement, in the same way as the natural resources or assets and liabilities related to socio-economic activities are not included in the financial statement.

Is it sufficient to state that an asset or liability is a "present" resource, or must there be a past event that occurs and which approach should be used to associate an asset or a liability with a specific entity?
The consultation paper discusses different approaches how to link assets and liabilities to the accounting entity and discusses a number of different approaches how to determine whether an asset or a liability can be said to belong to the accounting entity:

1. The accounting entity has control of the asset/liability

2. The accounting entity has the economic ownership and thus has the access to benefits but also derives risks of the asset

3. The accounting entity can restrict or deny the ownership of the asset for others

The term accounting entity is not a unique term and the definition of an asset/liability must therefore vary depending on whether you are preparing an institutional account, a ministry statement or a balance of the entire state.

In preparing the Danish government accounts there is a number of different assets and liabilities which do not appear in each institution's balance sheet, for example, the total state overviews of loans and long term receivables, securities and capital deposits, guarantees etc.

Are public sector rights as those associated with the power to tax only assets when those powers are exercised or is there en intermediate event that is more appropriate - and are public sector entity obligations such as those associated with its duties and responsibilities as a government, perpetual obligations, obligations only when they are claims, or is there an appropriate intermediate event that is more appropriate?

In Denmark we do not include public sector rights as those associated with the power to pay tax in our financial statements. In the same way we do not include public sector entity obligations such as those associated with its duties and responsibilities as a government.

3. Specific comments concerning elements and recognition of revenue and expenses

The Consultation Paper contains main topics concerning recognition and measurement of revenues and expenses:

- What basic approach should be chosen regarding definition and recognition of revenue and expenses?
- What are the basic characteristics to revenue and expenses?

- Are there other potential elements that should be taken into account as revenue or expenses?
- How should uncertainty be handled in terms of recognition?

The consultation paper introduces two approaches to the substance of the income statement:

- The revenue and expense-led approach
- The asset and liability-led approach

The consultation paper asks the question, **if revenues and expenses should 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)**.

In the Danish public sector accounting requirements a modified transaction-based approach (revenue and expense-led approach) has been chosen. This choice is based on the view that purpose of the financial statement is to compare and monitor the application of resources and the performance of central government institutions. Furthermore the purpose of the Danish accounting requirements is to support good business management in the public sector.

The area of donations is an example where Denmark deviates from the pure revenue and expense-led approach, since significant donations are not allowed to affect the income statement as income or expenses regarding depreciations on donated assets. The deviation is based on the purpose stated in the general comments - the ability to estimate pricing on public services. Other reasons for deviating from the basic principles regarding elements and recognition could be considerations regarding the measurement of the use of appropriations.

The Danish requirements aims at creating visibility of the cost related to different activities rather than to ensure a true and fair valuation of balance sheet, because the focus is different from the situation in the private sector where focus is more on company valuation, future earning capacity and financial performance as an expression of return on invested capital.

As mentioned in the general comments in this memo, there are also exceptions regarding heritage assets. The heritage assets do not directly contribute to the production in the public institutions and therefore they are not recognized with value on the balance sheet. Additions to the heritage assets are recognized and measured by cost value, but at the end of the financial year the value is regulated to zero in value to not impact the balance sheet.

Regarding the basic characteristics of revenue and expenses the paper asks the question, **if the definitions of revenue and expenses should be limited to specific types of activities associated with operations.**

The financial statements and the income statement of central government institutions focuses, as mentioned above, on the activities associated with operations in general. The primary target group of financial reports in the public sector has not in relation to accounts focus on a specific operating activity. Therefore the income statement includes all items relating to operations. Amendments to the content of the income statement must have a management purposes and be in demand of the target group of the reporting. There are no immediate plans to narrow or redefine the target group and thus alter the content of the income statement of central government institutions.

In extension to the above the consultation paper discuss, **if there are there other potential elements that should be taken into account as revenue or expenses**.

Recognition of revenue and expenses related e.g. to natural resources or guarantees such pensions are not suitable for each institution's General Purpose Financial Reporting. This information can be reported in the Special Purpose Financial Reporting on a more aggregated level.

Certain obligations and issues of sustainability are economic topics which belong more in a political discussion about economic potential. Moreover, the measurement of these items is difficult and otherwise subject to judgment, which is problematic at the institution level.

An extended reporting could possibly include additional information about developments in the services and activities of institutions in relation to performance targets and performance contracts.

Regarding uncertainty the consultation paper discuss **if recognition criteria should 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.**

In relation to this the Danish public sector requirements follow the Danish national GAAP and e.g. contain the elements debt obligations, provisions and contingent assets/liability. This handles different degrees of uncertainty by using thresholds as

- *probable*
- *more likely than not*

- *possible but not likely*.

However, the public sector accounting requirements deviate regarding impairment as impairment tests are not applied and there has to be a very substantial/significant reason for impairment. This deviation is again based on considerations regarding the Danish appropriation system and to limit the liberty of making judgment in the financial statements of central government institutions.

IPSASB Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

Exposure Draft
- Role, Authority and Scope;
- Objectives and Users;
- Qualitative Characteristics; and
- Reporting Entity

Consultation Paper
- Elements and Recognition in Financial Statements

Consultation Paper
- Measurement of Assets and Liabilities in Financial Statements

responses to exposure draft and consultation papers

15 June 2011

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

Our ref: Responses/1106159 SC0161-163

Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street, 4th Floor
Toronto
Ontario M5V 3H2
CANADA
Submitted electronically
15 June 2010

Dear Stephenie Fox

IPSASB Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

Exposure Draft: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity

Consultation Paper: Elements and Recognition in Financial Statements

Consultation Paper: Measurement of Assets and Liabilities in Financial Statements

CIPFA is pleased to present its responses to these three consultations, which have been reviewed by CIPFA's Accounting and Auditing Standards Panel.

General comment

CIPFA strongly supports IPSASB's programme which helpfully develops public sector specific IPSASs on matters which are unique to the sector, and IFRS converged IPSASs on matters which are relevant to both private and public sectors. The conceptual work will inform the development of standards in future and we support the objective of achieving an optimum balance between maintaining comparability between sectors and addressing sector specific issues.

CIPFA therefore welcomes the continuing development of IPSASB's important work in developing a conceptual framework for public sector financial reporting, which will be helpful both where IPSASs are developed for circumstances covered by IFRS, and when dealing with sector specific matters. The importance of this work is particularly clear given developments in IFRS which may make it more difficult to apply those standards or the IASB conceptual framework directly to the circumstances of public sector entities. Because this work is so important, it is vital that the development of the framework is rigorous and is followed up by standards developed in an equally rigorous manner, supported through transparent consultation.

In the Board's previous consultation UK stakeholders expressed reservations about the widening of scope beyond matters which have traditionally been included in public sector financial reporting. CIPFA welcomes the current Exposure Draft's explanation of the way in which the Board approach the evolution of wider scope reporting. In particular we welcome the acknowledgement that IPSASB may address wider reporting needs through non-authoritative guidance. Even so, we would note that the Board has limited resources, and is committed to a substantial workload in completing development of the Conceptual Framework and more mainstream development such as an IPSAS on Entity Combinations

and 'maintenance' of converged IPSAS, such as Financial Instruments, where the relevant IFRS are undergoing substantial change. Given this we would urge caution in pursuing development of wider reporting beyond those topics, such as Long Term Fiscal Sustainability, which the Board has included in its work plan after specific consultation on the Board's agenda.

Specific Matters for Comment

CIPFA responses to the Specific Matters on which IPSASB would particularly value comment are provided for each of the three consultations, attached at Annexes A to C.

I hope this is a helpful contribution to the finalisation of IPSASB guidance. If you have any questions about this response, please contact Steven Cain (e:steven.cain@cipfa.org.uk, t:+44(0)20 7543 5794).

Yours sincerely
Paul Mason
Assistant Director
CIPFA
3 Robert Street, London WC2N 6RL

Responses/110615 SC0162
ANNEX B

CIPFA responses to the Specific Matters on which IPSASB would particularly value comment

IPSASB Consultation Paper

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

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) All of these should be recognised (b) While we accept that the term 'Economic Benefits' can be taken to encompass wider considerations such as the benefit provided by public services, we suggest that Option (i) is the clearest and most helpful formulation for the Framework, particularly as it avoids confusion with the narrow usage of economic benefits by the IASB, where it is considered purely in terms of profit seeking activities. That said, we do consider that service potential can be measured by reference to economic benefit even in the narrow sense, having regard to expenditures which would be made to provide the equivalent service.

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) On balance, while none of the proposed bases are without drawbacks, we consider that 'control' best links an asset with a specific entity. However further consideration will need to be given when developing this section of the framework as to whether 'control' refers to (inter alia): - the ability to exercise control or actual exercise of control; - exposure or rights to variable outcomes arising from the asset; - control over the asset or the service delivery capacity of the asset. While even in the private sector there is debate over which base should be used, the bases are less clearly defined in the public sector than in the private sector because of the functions, diverse nature, structure and legal powers of public sector entities. (b) We consider that an entity's enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others' access are essential characteristics of an asset. (c) There are no additional requirements that CIPFA is aware of.
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?
CIPFA considers that there must have been an event, or a series of events, that result in the creation of an asset. However in practice the difficulty is often whether there is an 'identifiable' past event. We consider that the need for an identifiable past event should not in principle limit the recognition of an asset. Instead, the more essential consideration is whether there exists a present resource available to the entity to meet its future obligations or contribute to the entity's service potential. Having said all of the above, we would note that the 'past event' approach may be helpful in providing a trigger for recognition in particular IPSAS standards.

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?

We consider that the power to tax and levy fees is in itself an asset.

However in our view it would be difficult to develop a workable approach to recognising and measuring a theoretical power to tax.

We therefore agree that when developing IPSAS standards which relate to assets, the power to tax and levy fees should be considered as assets only when:

- those powers are exercised; and
- the tax or levy due can be measured in such a way as to provide a faithful representation of the asset.

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) We have not identified any additional characteristics

(b) Arguably one of the greatest assets of the State to its population is social capital. For example the rule of law and associated property rights and good governance in the conduct of government through the avoidance of corruption and extortion. By permitting the peaceful and lawful enjoyment of property, commerce and trade is facilitated, innovation encouraged through maintenance of intellectual property rights, savings and investments are encouraged and so overall economic well being is enhanced. This is both a benefit in itself, and will generally result in a greater tax base and higher tax revenues.

The framework should acknowledge these kinds of asset exist and have a powerful effect on government finances.

However, in line with our discussion on Specific Matter for Comment 4 above, we suggest that for reasons of practicality these should not in general be recognised in financial statements.

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?

In answering this question, CIPFA has been careful not to assume a fully worked out definition of a public sector liability – this is a matter on which although IPSASB and others have consulted a number of times, and an internationally acceptable consensus has yet to emerge.

(a) CIPFA considers that elements (i), (ii), and (iii) should be included in the definition of a liability.

It is not clear to us how item (iv) differs from item (i) and we are not sure that any items not encompassed by (i) should be deemed to be liabilities.

(b) No. Requiring a settlement date would exclude, for example, important and decision useful information relating to expected payments of uncertain timing.

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?

In answering this question, CIPFA has again been careful not to assume a fully worked out definition of a public sector liability.

(a) We do not consider the ability to identify specific parties as an essential characteristic, although liabilities will generally relate to parties outside the reporting entity which can be identified in general terms.

(b) Yes. However it must be recognised that certain public sector entities are able to change the law such that they could negate a liability. The Framework should therefore consider what constitutes 'realistic' in the context of law making entities.

(c) For the reasons outlined in paragraph 3.35, we consider that 3.28 (c) provides the best approach: Enforceable contractual, constructive, and equitable obligations and all other constructive and equitable obligations from which the public sector entity cannot realistically withdraw.

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?

CIPFA considers that there must have been an event, or a series of events, that result in the creation of a liability. However in practice the difficulty is often whether there is an 'identifiable' past event.

We consider that the need for an identifiable past event should not limit the recognition of a liability. Instead, the more essential consideration is whether there exists a present obligation.

Having said all of the above, we would note that the 'past event' approach may be helpful in providing a trigger for recognition in particular IPSAS standards.

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) Consistent with the response to Specific Matter for Comment 7, we consider that the obligations which might potentially be recognised and measured as a liability should be those where there is no realistic alternative to avoid the obligation. While there may be a sense in which obligations arise from general duties and responsibilities, for reasons of practicality an approach which focuses on enforceability of claims or unavoidability is a better fit for liability definitions. The factors that would trigger a liability are likely to vary between jurisdictions, depending on legal systems, specific legislation and political factors. Inasmuch as there may be intermediate events relating to liabilities, these will mainly relate to determination that enforceable claims will occur or are likely to occur, even though the recipients have yet to be determined.

(b) Yes. As noted above enforceability can arise from contractual, constructive political or moral obligations.

(c) As is discussed at 3.59 - 3.60 of the Consultation Paper, sovereign powers may allow a government to avoid its liabilities for example by changing legislation. However we consider that it is necessary to assume that at the balance sheet date the government will meet all its liabilities that it is required to recognise under the relevant financial reporting framework and legislation in place at that time.

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?
(a) No. (b) No, although in the absence of an agreed definition we suggest that the discussion of public sector liabilities must, like the private sector discussions of the distinction between provisions and contingent liabilities, have regard to significant commitments which, while possibly avoidable or otherwise not recognisable as liabilities, are planned as part of the ongoing responsibilities of the reporting entity.
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) CIPFA considers that the most coherent and useful approach is to determine revenue and expenses by reference to changes in net assets during the period (b) While this is generally represented as the assets and liabilities approach it is not principally focused on assets and liabilities as ends in themselves. The approach provides a coherent and consistent way of defining revenue and expense flows to reflect economic substance, without the difficulties and risk of bias inherent in defining 'applicability'.
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) Defining equity or 'ownership' interest is particularly problematic for public sector entities, but this can usefully be conceived of as a residual. Current frameworks usefully distinguish flows to and from 'ownership' interests from the headline performance measure of operational activity and we consider that this is helpful (b) No. But at a standards level, it may be useful to separately disclose information on revenue and expenses associated with operations, for example in contrast to changes in financial position which arise from exogenous factors such as changes in market values.

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? (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?
(a) No (b) No
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?
(a) No. Deferrals do not need to be identified on the SOFP. The deferral models proposed seem to be based on considerations of inter-period equity which provide information which is important in some jurisdictions. However, while interperiod and intergenerational equity are important considerations, there is no consensus on whether or if there should be specific measurement and disclosure in Statements of Financial Position. Recognition is also likely to be problematic and potentially subjective. We consider that deferral information may often be relevant information, which should be brought to the attention of readers of financial reports, perhaps through narrative reporting, including in jurisdictions which do not primarily focus on inter-period equity. We do not however consider such deferrals to be elements of financial statements applicable in an international context.

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 noncontrolling 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?
(a) We consider that in general net assets/net liabilities should be treated as a 'residual interest'. However where an entity is financially accountable to another entity (even where the 'parent' cannot direct or control the operational policies of the 'subsidiary'), it may be helpful to treat the net assets/net liabilities as effectively constituting an 'ownership interest'. A relevant scenario is outlined in paragraph 5.19. An ownership interest might also occur if a jurisdiction allows private investment in a government owned entity. Also where funds or assets are held on trust by the government it may be useful to separately identify the interests of donors and the public, for example where a museum collection is gifted to the state. (b) No. CIPFA considers that this could be dealt with as a sub-category of liabilities. (c) Not that we are aware of.
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?
(a) Only where: - An 'ownership interest' exists as outlined above at Specific Matter for Comment 15 - The transactions are not related to operating activities (i.e. they are restricted to capital injections or payment to the 'ownership interest' by means of 'dividends' or other distribution of accumulated surpluses. (b) See above

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) We support the use of an evidence threshold approach, but it is difficult to separate the discussion of whether an event has occurred which potentially warrants recognition, from consideration of whether a reliable measurement approach is available. (b) We agree that a uniform threshold should be adopted in principle for the recognition of both assets and liabilities. Inasmuch as the threshold relates to the likelihood that an asset or liability exists, we suggest that the starting point should be that it is 'probable' or 'more likely than not'.
Specific Matter for Comment 18 Do you support the use of the same criteria for derecognition as for initial recognition?
Yes.
Specific Matter for Comment 19 Should the recognition criteria be an integral part of the element definitions, or separate and distinct requirements?
We consider that recognition is a distinct stage in the accounting process that takes place after considering whether an item meets the definition of an element.

Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West, 6th Floor
TORONTO ONTARIO CANADA M5V 3H2

By email: stepheniefox@ifac.org

Dear Stephenie

IPSASB Consultation Paper Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements

CPA Australia, the Institute of Chartered Accountants in Australia and the Institute of Public Accountants (the Joint Accounting Bodies) are pleased to respond to the IPSASB Conceptual Framework (CF) Consultation Paper (CP) Elements and Recognition.

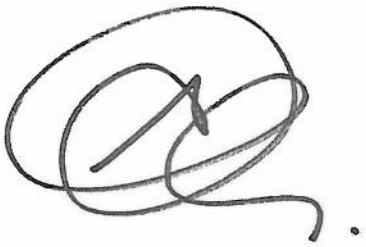
The Joint Accounting Bodies represent over 190,000 professional accountants in Australia. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

The Joint Accounting Bodies preferred approach is for an international reporting framework comprised of a single set of concepts designed for application to all sectors. However, we acknowledge that this is not the way that standard setting internationally is structured today. Nevertheless, we encourage the IPSASB to continue to initiate dialogue with the Trustees of the IFRS Foundation about the imperative for action to expand the objective of the IASB to develop a single set of accounting standards appropriate for all sectors. The Joint Accounting Bodies will continue to make such representations nationally and internationally.

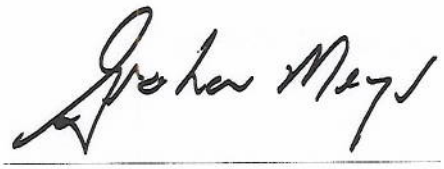
The Joint Accounting Bodies consider the completed conceptual frameworks of the IPSASB and the IASB/Financial Accounting Standards Board (FASB) will represent international best practice for entities of the public sector and the private for-profit sector respectively. However, the journey to completion is not proceeding contemporaneously. The IASB/FASB has decided not to proceed yet with a discussion paper on elements and recognition. We believe it appropriate that the IPSASB has exposed its thinking on this topic. However, we are concerned that differences in the decisions of the IPSASB and the IASB/FASB (when they eventually get to this topic) may prove problematic for transaction neutral jurisdictions like Australia should jurisdictions choose to maintain the approach of one set of standards and at the same time ensure that international investors understand that the financial reports of for-profit entities accord with the International Financial Reporting Standards (IFRS). To militate against the risk of this outcome, we encourage the IPSASB to maintain dialogue with the IASB/FASB on this topic and other conceptual framework topics.

The response of the Joint Accounting Bodies to the questions posed is appended. If you require further information on any of our views, please contact Mark Shying, CPA Australia by email mark.shying@cpaaustralia.com.au, Kerry Hicks, the Institute of Chartered Accountants by email kerry.hicks@charteredacccountants.com.au or Tom Ravlic, the Institute of Public Accountants by email tom.ravlic@publicaccountants.org.au.

Yours sincerely



Alex Malley
Chief Executive Officer
CPA Australia Ltd



Graham Meyer
Chief Executive Officer
Institute of Chartered Accountants in Australia



Andrew Conway
Chief Executive Officer
Institute of Public Accountants

Appendix

Specific Matters for Comments

Question 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?**

The Joint Accounting Bodies support the definition of an asset that covers all three types of benefits listed above.

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

The Joint Accounting Bodies believe that economic benefits or service potential is the essence of assets – an approach that was articulated in SAC 4 *Definition and Recognition of the Elements of Financial Statements* in pre-IFRS Australian GAAP. We consider economic benefits as synonymous with the notion of service potential. In pursuing their objectives, both public sector not-for-profit entities and profit seeking entities provide goods and services that have the capacity to satisfy human wants and needs. Both types of entity create utility and value in essentially the same way – by using assets to provide goods and services that their customers or beneficiaries desire or need. Thus, assets provide a means for entities to achieve their objectives and in the case of the public sector, that objective might only sometimes give rise to net cash inflows. While we do not differentiate economic benefits from service potential, as noted in paragraph 2.23 of the CF CP Elements and Recognition other commentators like to. We are agreeable to the use of either approach. The critical issue is that the notion of service potential is included in the Framework and that if option b(ii) is used, their synonymous nature is articulated. Irrespective of the final approach, a discussion of assets in the finalised Framework should highlight that the multiple objectives of public sector entities may result in their holding assets to use to either deliver goods and services in accordance with the entity's objectives, or to generate net cash inflows.

Question 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?**

The Joint Accounting Bodies consider control is an essential feature of an asset. We note that any discussion of approaches focuses people's attention on questions such as 'which asset?' – 'rights of use', 'rights of access', 'future rights to acquire', 'future rights to use', 'future rights to sell', 'rights to ownership of the underlying asset', and 'ownership of the underlying asset'. While we support an approach that includes access to rights, including the right to restrict or deny others' access to rights, we think in important that the Framework address the question of which asset (i.e., the unit of account issue).

We note that an approach based on risks and rewards has been used in some jurisdictions. Further, some commentators consider risks and rewards as a component of control and/or access to rights, and hence should be an input into the determination of control or access to rights. We suggest that the Framework include a discussion or risks and rewards that gives clarity to the distinction or interrelationship between the approaches of control and access to rights and the risks and rewards approach.

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?**

The Joint Accounting Bodies do not consider that an enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others' access, is a precondition to linking a resource to a specific entity, rather it could be an indicator.

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

The Joint Accounting Bodies are yet to identify any additional necessary requirements.

Question 3
Is it sufficient to state that an asset is a "present" resource, or must there be a past event that occurs?

The Joint Accounting Bodies believe it is sufficient to state that an asset is a present resource. However, we acknowledge that a past transaction or event may be useful as an indicator that an asset exists. Therefore, we support the statement to this effect made at paragraph 2.47 of the CF CP Elements and Recognition.

.

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 exercised, or is there an intermediate event that is more appropriate?

The Joint Accounting Bodies consider the unique powers and rights of government such as the power to tax and issue licences are assets. Therefore, we consider it important that the asset definition is kept general and broad. Whether or not an asset is recognised in the financial statements is, and should remain, a separate matter and be dependent on the asset satisfying prescribed recognition criteria. The finalised Framework must be clear on this sequencing.

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

The Joint Accounting Bodies have not identified any additional characteristics or other relevant issues. However we would encourage continued liaison with the IASB/FASB to develop a consistent definition of an asset.

Question 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.**

It is the view of the Joint Accounting Bodies that the Framework definition of a liability needs to be general and broad – that is, there is an obligation to transfer benefits to another party until it is settled and that the entity has no realistic alternative to avoid the obligation. To the extent that an entity has no realistic alternative to avoid the obligation, we agree that the types of obligations described in (a)(i) to (iii) are liabilities. Obligations to provide access to future resources are different from obligations to forgo future resources. We agree that an obligation to provide access is a liability, if the entity has no realistic alternative to avoid the obligation. However, we do not agree that an obligation to forgo future resources is a liability as the circumstance as described may lack an essential characteristic of a liability - an obligation to transfer benefits to another party until settled.

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

The Joint Accounting Bodies believe a settlement date is not an essential characteristic of a liability. However, we acknowledge that a settlement date may be useful as an indicator that a liability exists in the context of a contractual arrangement, but it is not always relevant or necessary.

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?

The Joint Accounting Bodies do not consider that the ability to identify a specific party(ies) outside the reporting entity to whom the entity is obligated should be considered an essential characteristic in defining a liability. Although we consider an essential characteristic of a liability is an obligation to transfer benefits to another party until settled, we do not think it essential to identify the other party.

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

Yes, the Joint Accounting Bodies 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?

The Joint Accounting Bodies support a definition of a liability that is kept general and broad. We consider that the definition of a liability should be applicable to all types of obligations with no distinction between exchange and non-exchange obligations. The approach (c) is the only approach that extends the application of constructive obligations to non-exchange transactions from which the public sector entity cannot realistically withdraw. Therefore, we think of it as the most supportable. Notwithstanding the prevalence of constructive obligations in the public sector (when compared with the private sector), we suggest that a better approach is for the IPSASB to focus the development of its definition of a liability on whether obligations are conditional or unconditional. We consider that an entity has a liability only in respect of unconditional obligations and that many obligations to provide future benefits (in a non-exchange setting) would be conditional obligations. We also consider that the definition of a liability should encompass unconditional stand ready obligations. We consider an entity has a liability when it has an unconditional obligation from which it cannot realistically withdraw, regardless of whether that obligation is contractual or constructive.

Question 8
Is it sufficient to state that a liability is a "present" obligation, or must there be a past event that occurs?

The Joint Accounting Bodies believe it is sufficient to state that a liability is a present obligation. However, we acknowledge that a past event may be useful as an indicator that a liability exists.

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?**

The Joint Accounting Bodies consider the inherent responsibilities of government to provide security, education, health and other services to its citizens do result in the existence of perpetual obligations to transfer benefits to another party and that the government has no realistic alternative to avoid these obligations, and therefore, they are a liability. We consider it important that the liability definition is kept general and broad. Whether or not a liability is recognised in the financial statements is, and should remain, a separate matter and be dependent on the liability satisfying prescribed recognition criteria. The finalised Framework must be clear on this sequencing.

b. **Is the enforceability of an obligation an essential characteristic of a liability?**

The Joint Accounting Bodies do not support 'enforceability of an obligation' as an essential characteristic of a liability. However, we acknowledge that enforceability may be useful as an indicator that a liability exists.

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?**

The Joint Accounting Bodies believe a general and broad definition of liabilities is able to deal appropriately with the issue of sovereign power. As noted in our response to Question 7(c) above we consider that an entity has a liability when it has an unconditional obligation from which it cannot realistically withdraw. Therefore, the definition of a liability will only be satisfied on those occasions when the consequences to the government of exercising its sovereign power to avoid its obligations are such that withdrawal is not a realistic option. In all other instances, the liability definition will not be satisfied

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

The Joint Accounting Bodies have not identified any additional characteristics or other relevant issues. However we would encourage continued liaison with the IASB/FASB to develop a consistent definition of a liability.

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),**
b. **or by changes in net assets, defined as resources and obligations, "during" the current period (derived from an asset and liability-led approach)?**
c. **What arguments do you consider most important in coming to your decision on the preferred approach?**

The Joint Accounting Bodies consider that revenues and expenses should be determined by an 'asset and liability-led approach'. We believe that economic benefits or service potential as well as the obligation to transfer them are the essential characteristics of the asset/liability and that revenues and expenses should reflect changes in those economic benefits or service potential and obligations. We agree with the views expressed at paragraph 4.11 of the CF CP Elements and Recognition that assets and liabilities are the principal building blocks of the system to give meaning to financial performance.

Question 12

a. **Should transactions with residual/equity interests be excluded from revenues and expenses?**

The Joint Accounting Bodies believe that when the transaction is one with the holders of residual/equity interests who are acting in that capacity, such transactions should be excluded from revenues and expenses. Therefore, we support the view outlined in paragraph 4.41 of the CF CP Elements and Recognition that contributions intended to be an investment in the initial operating capacity of the entity or, subsequently to increase it, should be excluded from revenues. We also support the related treatment of distributions outlined in paragraph 4.41.

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

The Joint Accounting Bodies consider the definitions of revenue and expense should include inflows from all transactions and events other than transactions with the holders of residual/equity interests when they are acting in that capacity. We do not support limiting the definitions to specific types of activities.
We note that the IASB/FASB use of "other comprehensive income" does not have a basis in its CF. We encourage the IPSASB to explore its use as part of the development of its CF in liaison with the IASB/FASB to develop a consistent definition.

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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?**
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?**

The Joint Accounting Bodies have not identified any other characteristics or issues. However we would encourage continued liaison with the IASB/FASB to develop a consistent definition of revenues and expenses.

Question 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?**

The Joint Accounting Bodies do not support the identification of deferred outflows and deferred inflows as they are not derived from the 'asset and liability-led approach'.

Question 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?**

The Joint Accounting Bodies agree it is important that the finalised Framework specify the status of ownership-type interests in the public sector. It is our view that when a transaction is one with the holders of residual/equity interests and they acting in that capacity, such transactions should be excluded from revenues and expenses. Therefore, the finalised Framework will need to acknowledge the existence of, on occasions, ownership interests in the public sector and in some cases there may be no identifiable ownership interest. For this reason, we consider that net assets/net liabilities should be regarded as a residual amount, and in many cases, this residual will represent an ownership interest. Therefore, we support the approach set out in paragraph 5.25(a) of defining net assets/net liabilities and treating any specific ownership interest as a sub classification of net assets.

Question 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?**

No, the Joint Accounting Bodies do not believe it is necessary to define as separate elements transactions with residual/equity interests. While we consider that net assets/net liabilities should be regarded as a residual amount, and in many cases, this residual will represent an ownership interest, there will not be an identifiable ownership interest in every case. If a residual amount approach is adopted, we do not consider that this precludes acknowledgement of ownership interests. However, we do not consider that ownership interests should be defined as a separate element.

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?**
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?**
c. **If not, what threshold is reasonable for asset recognition and for liability recognition?**

The Joint Accounting Bodies support a recognition criteria that requires preparers to utilise neutral judgment to review and assess all available evidence in determining whether sufficient evidence exists that an asset or liability should be recognised initially, whether it continues to qualify for recognition, or whether there has been an addition to an existing asset or liability.

Question 18
Do you support the use of the same criteria for derecognition as for initial recognition?

The Joint Accounting Bodies support the finalised Framework utilising the same criteria for derecognition as for recognition.

Question 19
Should the recognition criteria be an integral part of the element definitions, or separate and distinct requirements?

The Joint Accounting Bodies believe that the finalised Framework needs to be clear on the relationship of the recognition criteria to the element definitions. We consider it important that the element definitions are kept general and broad. Whether or not an element is recognised in the financial statements is, and should remain, a separate matter and be dependent on the element satisfying prescribed recognition criteria. The finalised Framework must be clear about this sequencing.

UNITED NATIONS SYSTEM

SYSTEME DES NATIONS UNIES

Chief Executives Board for Coordination

Conseil des chefs de secrétariat des organismes des Nations Unies pour la coordination

SUBMISSION: Conceptual Framework Consultation Paper Phase 2: *Elements and Recognition in Financial Statements*

13 June 2011

Ms Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto Ontario Canada M5V 3H2

Dear Stephenie,

Conceptual Framework Consultation Paper Phase 2

1 Thank you for the opportunity to comment on *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements.*

United Nations System Task Force on Accounting Standards

2 These comments represent the views of Members of the United Nations System Task Force on Accounting Standards (Task Force). The Task Force is an inter-agency group consisting of directors of accounting, chief accountants and chief financial officers from United Nations System organizations. The individual organizations that provided comments on this submission and concurred with its submission to the IPSASB are listed in Appendix 1. Where an individual organization disagreed with a particular recommendation but agreed to the recommendation going forward to the IPSASB, this has been noted against the individual recommendation in Appendix 2.

Importance of the Conceptual Framework

3 The Task Force appreciates the work that the IPSASB is carrying out in developing accounting standards for public sector entities and international organizations such as those making up the United Nations System. The Conceptual Framework Consultation Paper Phase 2 is an important development since it is part of a series of the expected consultations papers and exposure drafts of the IPSASB Conceptual Framework. The Conceptual Framework is envisaged to make explicit the concepts that are to be applied in developing IPSASs and other documents that provide guidance on

information included in general purpose financial reports. All United Nations System organizations are looking forward to the development and finalization of the IPSASB Conceptual Framework.

General Comments

4 We support the IPSASB efforts in developing the conceptual framework and have the following general comments pertaining to our understanding of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements* (Consultation Paper):

(a) General Purpose Financial Statements (GPFSs) and General Purpose Financial Reports (GPFRs) are sometimes used interchangeably in the Consultation Paper, whereas Exposure Draft 1 (ED 1) makes a clear distinction between these two items. For example, para. 2.2 of the Consultation Paper defines users of financial statements as recipients of goods and providers of resources, although these major groups of users were first identified by ED 1 as users of GPFRs. IPSAS 1, which is one of the Standards regulating GPFSs, defines users differently. The Task Force recommends that the terms GPFSs and GPFRs be used more consistently.

(b) ED 1 states that GPFSs and notes thereto remain at the core part of the GPFRs, however the latter can report information about the past, the present and the future that is useful to users. Such information include financial and non-financial quantitative and qualitative information about the achievement of financial and service delivery objectives in the current reporting period, and anticipated future service delivery activities and resource needs. Our understanding is that IPSAS 1, para. 18, already introduced a concept of reporting on achievement of service delivery and financial objectives as supplementary information to better meet needs of users for decision-making and accountability. The difference between reporting such information under IPSAS 1 when preparing GPFS or under Conceptual Framework when preparing GPFRs is not clearly outlined. The Task Force is of the view that when the Consultation Paper progresses to draft Exposure Draft, the latter should clarify the relationship between GPFSs and GPFRs in this regard and provide criteria which can be used to clearly distinguish between GPFRs as opposed to GPFSs which include supplementary information on achievement of service delivery and financial objectives. We assume that the draft Exposure Draft will also address implementation issues of the transition from GPFSs to GPFRs for those reporting entities who will choose to conform to guidance provided by the Conceptual Framework.

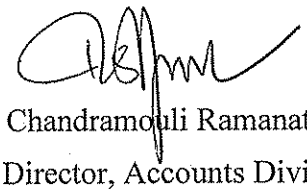
(c) Discussion of the Consultation Paper on elements and recognition in financial statements (including majority of examples) is biased heavily towards specific attributes and challenges of governments, making it less useful and applicable for use by other public sector entities. The Task Force is of the view that IPSASB should expand consideration of issues when progressing the Consultation Paper to draft Exposure Draft to make them more applicable and useful to public sector entities other than governments.

Specific Matters for Comments and Comments on Further Issues

5 Our detailed comments on the specific matters for comment identified in *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements* and further issues are attached as Appendix 2. There is one area of disagreement with the proposed reporting requirements, while many other specific matters for comment were agreed to partially. In some cases, the Task Force was unable to take a position due to limited guidance or limited applicability of issues to public sector entities other than governments; the position of the Task Force has been explained in all cases along with a request for further clarification to be included in the future draft Exposure Draft, where applicable.

6 Should you have any queries on our comments, please contact Ms. Dinara Alieva, Financial Analyst, System-wide IPSAS Project Team at alievad@un.org.

Yours sincerely,



Chandramouli Ramanathan
Director, Accounts Division, United Nations
& Chair, Task Force on Accounting Standards
304 East 45th Street, Room FF-726
New York, NY 10017, USA
ramanathanc@un.org

APPENDIX 1: UNITED NATIONS SYSTEM TASK FORCE ON ACCOUNTING STANDARDS

Task Force Members from the following organizations reviewed this submission and concurred with its contents.

Organisation	Agree (Disagree)
1. FAO	Agree
2. IAEA	Agree
3. ICAO	Agree
4. ILO	Agree
5. IMO	Agree
6. ITU	Agree
7. PAHO	Agree
8. UN	Agree
9. UNDP	Agree
10. UNESCO	Agree
11. UNFPA	Agree
12. UNHCR	Agree
13. UNICEF	Agree
14. UNIDO	Agree
15. UNOPS	Agree
16. UNRWA	Agree
17. UPU	Agree
18. WFP	Agree
19. WHO	Agree
20. WIPO	Agree
21. WMO	Agree
22. WTO (Tourism)	Agree
23. UNWomen	Agree

APPENDIX 2: CONCEPTUAL FRAMEWORK FOR GENERAL PURSPOSE FINANCIAL REPROTING BY PUBLIC SECTOR ENTITIES: ELEMENTS AND RECOGNTION IN FINANCIAL STATEMENTS

In response to the IPSAS request for comments on these specific matters and whether they are agreeable:

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?

Response:

Agree on (i) and (ii). With regard to (iii) unconditional rights to receive resources – although the proposed concept is explained clearly, it is not clear how an asset which constitutes an unconditional right to receive resources would be measured and presented by preparers of GPFSs. Is it practical (from a cost/benefit perspective) or even possible to establish fair value of an unconditional right to receive resources? The example used in para. 2.20 refers to contracts with an insurance company to unconditionally receive protection against losses incurred by fire damage for the next two years. First, it is not possible to predict with a required degree of certainty whether a reporting entity would suffer fire damage in the next two years. Thus this benefit may never materialize. If, however, fire damage should occur within the defined period, it would not be possible to predict the monetary value of the damage before it happens. Additionally, GPFSs of a reporting entity are prepared on going concern basis and not on the assumption that a significant part of the operations might be damaged. It is an operational risk which is mitigated by devising a contingency plan. In this case, should fire damage occur in the future impacting a certain value of an entity's property, an insurer will compensate losses in full to restore/replace the property to its pre-fire condition; the net economic effect of these events is nil. The Task Force requests that the concept be further clarified, should IPSASB wish to continue to consider an unconditional right to receive resources as a benefit to be used in defining an asset.

(b) What term should be used in the definition of an asset:

(i) Economic benefits and service potential; or

(ii) Economic benefits?

Response:

The Task Force observes that, according to para. 2.13 of the Consultation Paper, service potential is defined as a type of economic benefit, hence above proposed option (i) appears to be inconsistent and repetitive within the framework of the Consultation Paper. However, we acknowledge that historically the term 'economic benefit' was associated with profit-oriented reporting entities. In this regard, extension of the definition of an asset to include reference to service potential will be useful in setting public sector definition of asset apart from commercial sector's counterparts. The Task Force supports option (i) and suggests that the language could be revised to address above mentioned inconsistency upon progressing of the Consultation Paper to draft Exposure Draft.

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?

Response:

The Task Force views each of the proposed approaches to be suitable, independently or in combination, to trigger the assessment of association of an asset with a specific entity. However, considering limitations of each approach, presence of one or a combination of these factors can not be solely relied on to determine association of an asset with a specific entity. In relation to (i) and (ii), if an asset is shared between reporting entities (legally or in substance), while one entity has 'control' over the shared asset, other(s) may in substance have access to majority of rewards and risks related to it. In relation to (iii), if an asset is co-owned, then more than one reporting entity might have the right to restrict or deny access to rights over the asset to parties which are external to the co-ownership arrangement. The Task Force recommends that the IPSAS Board expand its discussion of practical application of these approaches in operational scenarios which may result in associating an asset with more than one entity if above proposed approach is followed.

(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?

Response:

The Task Force agrees with the proposed view that an entity's enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others' access can be used to trigger an assessment of linkage between a resource and a specific entity. However this approach should not replace other approaches (specified above) or be used as an exclusive criterion to link a resource to a specific entity.

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

Response:

No Comment.

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?

Response:

The Task Force concurs with the view that existence of a resource at the reporting date is a more important consideration than whether a resource is a result of past transaction(s). However, we note that it is a rare occurrence that an asset which exists at the reporting date did not originate from an event which occurred prior to or at the end of the reporting period.

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?

Response:

Some United Nations System organizations have rights to issue international patents, trademarks and levy fees as prescribed by international treaties and agreements. The Task Force is of the view that rights to issue patents, licenses and levy fees can be considered

for recognition as assets when those rights are exercised. However, in order to recognize any resource as an asset in financial reports of an entity, such resource should meet the definition of an asset and the reporting entity should be able to measure it reliably.

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?

Response:

No Comment.

(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:

No Comment.

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.

Response:

Agree on (i). For (ii), please refer to Task Force's comments on uncertainty and absence of sufficient guidance on recognition and measurement of unconditional rights to receive resources provided in the Specific matter for comment 1, as this type of obligation (ii) is a mirror concept of the said benefit and presents the same complications. The Task Force requests further elaboration on this should IPSASB wish to continue to consider using an unconditional obligation to define a liability.

Difference between (i) and (iii) is not clearly defined. A performance obligation is defined as an obligation in an agreement between the government/other public sector entity and another party to transfer a resource (or provide a service) to the other party (para. 3.15). It appears that performance obligation is therefore a type of obligation described in (i) above, i.e. an obligation to transfer benefits and provide goods and

services. Hence Task Force does not consider it useful to provide further comments on applicability of obligation (iii) to the definition of a liability at this stage and requests further clarification on this in the future draft Exposure Draft.

Applicability of an obligation (iv) to and its occurrence in transactions of public sector entities other than government appears to be very limited. Task Force therefore recommends omitting reference to this type of obligation in defining a liability, as definitions should be well balanced and applicable to majority of preparers of GPFSs. Should there be a need to discuss this type of obligations in more detail, it can be done in a more specific format to target interested parties, possibly within the framework of the Conceptual Framework project.

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

Specific Matter for Comment 7

Response:

The Task Force has no reservations about the proposed reference to "the occurrence of a specified future event" rather then to settlement date in identifying a liability (para. 3.22), provided that unspecified settlement date should not be viewed as a characteristic of a liability.

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?

Response:

The Task Force is of the view that the inability to identify a specific party outside the reporting entity should not prevent the latter from recognizing a liability in its GPFSs if an item meets all relevant recognition criteria.

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

Response:

Agree.

(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:

The Task Force supports approach (a). In relation to approaches (b) and (c), it is our view that non-exchange transactions should not be treated differently from exchange transactions, regardless of their legal form, in linking the entity and the obligation if reporting entity intends to comply with the obligation. However, taking into account complexity of application of approaches (b) and (c), as well as possibility of varying interpretations and significant discretion that approaches (b) and (c) can be subjected to, the Task Force requests the IPSASB either to provide significantly more expanded analysis on the subject before the earlier can finalize its view or to move away from approaches (b) and (c) entirely.

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?

Response:

The Task Force concurs with the view that existence of a liability at the reporting date is a more important consideration than whether it is a result of past transaction (s). We note, however, that it is a rare occurrence than a liability which exists at the reporting date did not originate from an event which occurred prior to or at the end of the reporting period.

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?

Response:

Having considered the above specific matter for comment 9 in the context of United Nations System, the Task Force disagrees with the view that duties and responsibilities of organizations in carrying out their mandate should be considered as obligations and/or liabilities to be reported in the GPFSs. The existence of United Nations System organizations is justified by the need to carry out their respective mandates and their performance is monitored by the Member States, many of whom are also, in broad terms, recipients of services provided by the said organizations. Valuing the reason for existence of organizations as a liability, expressed in monetary terms, in its GPFS is too broad and too controversial of a concept to be considered within Conceptual Framework or any IPSAS reporting framework.

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

Response:

It is a view of the Task Force that enforceability in substance, not in form, is indeed an essential criterion for recognition of a liability. However, if a reporting entity wishes to recognize obligations beyond those which are enforceable, on the basis that it intends to comply with those obligations to carry out its mandate or for other justifiable reasons, it should be allowed (but not required) to do so. This is especially applicable in cases when the voluntary recognition approach would enhance usefulness of GPFSs for users.

(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:

No Comment. United Nations System organizations do not have rights to make, amend and repel legal provisions similar to authority of a government.

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?

Response:

No Comment.

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

Response:

The Task Force recommends the IPSASB to take a conservative approach while exploring the possibility of expanding types of obligations which can be classified as liabilities in GPFSs. Many operational processes and economic transactions of public sector organizations are subject to significant discretion, presumably much more so than in private sector entities. Many public sector organizations carry out tasks that directly impact lives of hundreds of millions of people in various regions of the world, and hence they are subjected to increased level of scrutiny from donors, recipients and general public. These organizations also often have to divert their activities and resources from initial plan to address people's needs triggered by unexpected events and problems, like natural disasters or new areas of military conflict. It will not be possible or practical to have a comprehensive list of all liabilities that organizations of such scale while

recognizing and measuring these liabilities completely and reliably, with reasonable cost/benefit balance. Therefore, the position of the Task Force is that IPSASB should only consider introduction of new or expanded concepts to this element of financial statements if there is an intention to supplement them with in-depth analysis for all preparers of GPFSs who wish to conform to the Conceptual Framework.

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)?

Response:

IPSAS 23 promulgates that revenues are to be recognized at the same time as the relating asset is recognized, which is an essence of an asset and liability-led approach. The Task Force therefore recommends that revenues continue to be recognized on an asset and liability-led approach. Pending IPSASB feedback to the request for new/revised examples which would depict impact of using both recognition approaches to non-capitalizable expenses (comments to the specific matter 13 (b) below), the Task Force tentatively supports an asset and liability-led approach for recognition of expenses.

(b) What arguments do you consider most important in coming to your decision on the preferred approach?

Response:

Both approaches have their advantages as well as weaknesses. Recognition of revenues in IPSAS, as the latter currently stand, appears to be based on an asset and liability-led approach. This approach is considered by many preparers of GPFS as more transparent for reporting non-exchange transactions. Provided that there are no overwhelming benefits of changing currently used approach to a revenue and expense-led approach, the Task Force's position on this specific matter for comment is to maintain current approach. It should also be noted that a change to a different approach would require an investment of considerable additional efforts and resources by preparers of GPFSs who already comply with IPSAS or intend to implement the standards in foreseeable future. Had this change been viewed as a key measure which would allow reporting entities to improve usefulness of their GPFSs for users, additional work could have been justified.

Specific Matter for Comment 12

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

Response:

The Task Force's position on this specific matter for comment is that transactions with residual/equity interests should not be excluded from revenues and expenses, as long as they are associated with supporting current and future capacity of a reporting entity and not associated with future return on the specific investment.

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

Response:

The basis for conclusions for IPSAS 23 refers to the position taken by IPSASB in concurrence with the views of the Board's Steering Committee against "adopting an approach that focuses on the development of requirements for accounting for revenue arising from a range of specific types of non-exchange transactions (IPSAS 23, para. BC7)". Such approach was thought to bring with it "consequent risks that the resultant Standard would not provide comprehensive guidance for all revenue from non-exchange transactions". The Task Force concurs with the position of the IPSASB outlined in the basis for conclusions for IPSAS 23 and is of the view that broad principles for recognition of revenue should be maintained.

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?

Response:

No Comment.

(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?

Response:

Examples included in the Consultation Paper depicting impact of using an asset and liability-led approach as compared to revenue and expense-led approach to the same economic transactions with different resulting presentations were quite useful. However, they were both focused on demonstrating effect of using different approaches on revenues rather than expenses. The first example referred to capital construction and therefore expenses in this example were capitalized, to be depreciated over a period of time. The second example was focused solely on recognition of tax collections without occurrence of any related expense(s). There was no illustration of a reporting entity

dealing with non-capitalizable expenses incurred during the period under an asset and liability-led approach as compared to revenue and expense-led approach. The Task Force believes that it is essential to bridge this gap by revising existing examples or adding new examples which would depict impact of using both recognition approaches to non-capitalizable expenses before final comments on the preferred approach are sought.

Specific Matter for Comment 14

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

Response:

The Task Force's view is that presentation of deferrals on the statement of financial position should be optional, as its usefulness to users of GPFSs varies between reporting entities. For example, based on discussion and examples relevant to this specific matter for comment, governments might be more interested in defining deferrals on the face of the GPFSs, whereas other public sector entities may choose to present them as a sub-component of assets and liabilities or net assets/net liabilities or not identify them on the statement of financial position, depending of the needs of users of their GPFSs.

The Task Force notes that the Consultation Paper implies that deferred outflows and deferred inflows are derived from the revenue and expense-led approach to elements and financial performance. The revenue and expense-led approach defines the elements of revenue and expense on the basis of their applicability to the current period, resulting in deferral of certain costs and resources to future periods. The asset and liability-led approach is based on presentation of resources and obligations at the reporting date, which elimitaes the need to determine which transactions and events that affect financial position are included or excluded from any specific period's measure of financial performance.

(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.

Response:

Please see comments above to the specific matter 14(a).

(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?

Response:

The Task Force has no reservations regarding definitions of a deferred outflow and deferred inflow as set out in para. 5.8 of the Consultation Paper, regardless of whether or not deferred outflows and inflows are defined as separate elements of GPFSs. These definitions are likely to be useful to those preparers of GPFSs who will decide to identify deferrals separately on their statement of financial position.

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?

Response:

The view of the Task Force is that net assets/net liabilities could be considered as residual interest in the capability of the entity to resource future operations, based on financial expectations of resource providers and service recipients, as outlined in para 5.21 of the Consultation Paper. It should be noted that residual interest, if any, is usually shared by multiple resource providers which contribute resources to a public sector entity without the intent to receive benefits in exchange. On the other hand, the residual amount approach might also be used as most generic and widely applicable to net assets/net liabilities.

(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?

Response:

The concept of ownership interest should only be incorporated in the definition of net assets/net liabilities if it is expected that it will be applicable to majority of GPFSs preparers. Otherwise, it can still be discussed, if considered applicable to some public sector entities, in a more appropriate format within the framework of this Consultation Paper.

(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:

Each public sector entity has a distinctively individual history of establishment and relations with resource providers and service recipients. Hence a reporting entity should be allowed to choose how to present its net assets/net liabilities in the GPFSs, including various components of the earlier, to best address needs of users of their GPFSs.

Specific Matter for Comment 16

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

Response:

The Consultation Paper recognizes the fact that a residual interest is far less applicable to public sector entities as compared to private sector entities and, if at all applicable, it usually represents an interest in the entity's operating capability rather than "ownership interest". In addition, a residual interest is "unlikely to be able to be sold, exchanged, transferred, or redeemed. This type of interest may lead to entitlements in the event of an entity being wound up, although this may not be explicitly stated" (para. 5.37). The Task Force therefore supports the option of reflecting fairly the items/transactions with residual/equity interest without creating the need for a separate element.

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

Response:

The Task Force reiterates its position, described above, of not creating separate elements for transactions with residual/equity interest. However, if these transactions were to become separate items, characteristics (a) and (b) contained in para. 5.34 of the Consultation Paper would be relevant. Characteristic (c) would need to be modified to remove link between a contribution and entitlement to distribution of future benefits or service potential and characteristic (d) is considered to be not applicable in public sector context.

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?

Response:

Considering the significant diversity of items and transactions that a reporting entity is involved and complexity of recognition stage of the accounting process, the Task Force holds the view that limiting recognition criteria to just one method may negatively impact on quality of the outcome.

Hence a reporting entity should be able to use either evidence thresholds or a neutral judgment to deal with evidence uncertainty in recognition of items in GPFSs, as long as

the preferred method is used consistently, in order to produce the GPFSs which provide a fair depiction of the relevant economic phenomena.

Items that cannot be reliably measured cannot be recognized in the GPFSs, therefore a measurement attribute is essential in forming recognition criteria, regardless of whether an entity uses evidence thresholds method or neutral judgment method.

(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?

Response:

The Task Force supports the proposed position to use a uniform threshold approach for both assets and liabilities by those reporting entities which choose to use the threshold approach. This position is acceptable as long as it improves usefulness of GPFSs for their users, especially since IPSASB considers that prudence should not be a factor in determining threshold criteria. Those reporting entities which choose to use the threshold approach for their recognition criteria should be able to choose the level of the threshold which is relevant to their GPFSs. The entities should be required to disclose the threshold level in their accounting policy, contained in the GPFSs, along with an explanation of why this level of the threshold was used, to increase transparency of accounting policies used to prepare GPFSs.

Specific Matter for Comment 18

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

Response:

The Task Force supports the use of the same criteria for derecogniton as for initial recognition, provided that this approach improves presentation and enhances usefulness of information for users of GPFSs.

Specific Matter for Comment 19

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

Response:

The position of the Task Force on this specific matter for comment is that definition should not incorporate recognition elements; however measurability attribute should be a part of recognition criteria. The rationale behind this approach is that an item or a transaction does not cease to exist because it does not meet recognition criteria for inclusion in the GPFSs, whereas if an item cannot be measured reliably, it should not be recognized in the GPFSs. Thus measurement attribute should be a part of the recognition criteria.

Government of Canada | Gouvernement du Canada

Ottawa, Canada
K1A 0R5

The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West, 6th Floor
Toronto, Ontario
M5V 3H2

Dear Sir/Madam:

Re: Consultation Paper: Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements

Thank you for the opportunity to comment on the Consultation Paper – *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements* (the CP) issued in December 2010.

The Government of Canada bases its accounting policies on the Accounting Standards issued by the Public Sector Accounting Board (PSAB) of the Canadian Institute of Chartered Accountants (CICA). Our government is therefore not required to follow the International Public Sector Accounting Standards (IPSAS). However, given that PSAB is reviewing its conceptual framework and will use the work of IPSASB in its deliberations, we have a vested interest in the CP. As well, we consider IPSAS to be an important secondary source of Generally Accepted Accounting Principles (GAAP).

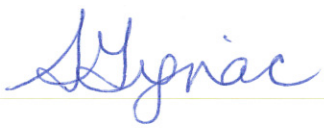
We commend the IPSASB for recognizing the importance of developing a robust conceptual framework as the basis for IPSAS and we believe it is extremely important to consider the unique needs of the public sector and assess the definitions of elements and their recognition within this context. This may result in some deviation from the framework for international private sector standards, but we believe the unique operating environment of the public sector must be reflected in the conceptual framework.

As a general comment, where it was suggested that comments not consider recognition and measurement, we would caution that the discussion of the definition of elements of financial statements must be carried out in tandem with recognition and measurement. We believe it is imperative that the impact on recognition and measurement be understood fully in order to make appropriate decisions with respect to the element definitions.

The attached Annex responds to the specific questions raised in the CP.

We thank you again for providing the opportunity to comment on this CP. If you have further questions related to these comments, please do not hesitate to contact either Ms. Diane Peressini at Diane.Peressini@tbs-sct.gc.ca (613-957-9671) or myself at Suzie.Gignac@tbs-sct.gc.ca (613-952-0886).

Yours sincerely,



Suzie Gignac
Government Accounting Policy and
Reporting Division

c.c.: Mr. James Ralston, Comptroller General of Canada

Att.

Annex

Response Questionnaire: Elements and Recognition in Financial Statements

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?

As defined in the CP, service potential and net cash inflows are relevant to the definition of an asset. However, in developing standards at the level of specific elements one aspect may be more relevant. Net cash inflows are integral to the substance of financial assets such as amounts receivable, investments, and advances. However, for non-financial assets such as capital assets and inventory service potential is the most relevant aspect.

Governments are socio-economic entities focussed on providing services to the public, therefore the service potential of assets should be the primary consideration for the definition of a capital asset with reference to net cash inflows only when appropriate in cases where a capital asset is used directly in a cash generating activity. Net cash inflows may be more appropriate in a profit generating environment than in a government context to value non-financial assets.

We also believe that additional clarification is required with respect to including unconditional rights to receive resources as part of the definition of an asset. In situations where these rights have been purchased by a government, there is likely support for recognition as an asset; however, we are concerned that introducing this concept may be interpreted broadly to include items such as Crown lands, forest and water rights, and other natural resources, all of which are currently not recorded as assets by governments. We would also point out the significant effort and judgement that would be required to measure these types of assets in countries such as Canada.

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

Economic benefits and service potential should be used in the definition of an asset.

We would not support focussing the definition of an asset exclusively on economic benefits as, in particular for non-financial assets, this does not reflect the environment in which a public sector entity operates.

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?

We believe that a control-based approach should be used in the context of public sector assets as it encompasses an entity's ability to control access to the service potential of its resources in order to deliver services to the public. We also believe that the control focus incorporates certain aspects of the risks and rewards approach, since through control, a government will be inherently exposed to the risks and rewards associated with the economic ownership of its assets.

Further, an exclusive focus on risks and rewards would shift the analysis to a government's exposure to the underlying economic attributes of a resource. This approach would be better applied when assets are based on economic benefits rather than on service potential. A risks and rewards approach would also require significant judgement to assess the relative risks and rewards making it challenging to apply in practice. We believe that a control approach is less complex to apply, is consistent with assessing the service potential of a government's resource, and also implicitly considers risks and rewards and access to benefits.

(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?

As noted previously, we believe that an entity's ability to deny, restrict, or otherwise regulate access to the benefits associated with a resource is an important consideration in assessing the entity's control of the resource and whether it should be reported accordingly.

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

We do not believe that there are any additional requirements necessary to establish a link between the entity and an asset.

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?

We believe that an asset must result from a past event as this is generally necessary to establish the control and right of access to the benefits associated with a resource and to expose the entity to the risks and rewards of the asset.

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?

As noted previously, we believe that the existence of a past event is necessary to consider a resource as an asset of an entity. Consistent with this view, we believe that rights and powers of a public sector entity should only be recognized after the right or power has been exercised and provides evidence of the right to access benefits. We feel that including assets related to the power to tax and levy fees would reduce the relevance and reliability of the financial statements to users as a result of the significant judgement and estimates that would be required to value future revenues. It also does not support the revenue expense-led approach as discussed in Matter for Comment 13 below.

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?

We do not believe that there are additional characteristics that are essential to the development of the definition of an asset.

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

As we have noted in our cover letter, we would encourage the IPSASB to consider the unique public sector operating environment and the needs of primary users of the financial statements when considering the concept of assets. Governments have a focus on providing service to the public in an efficient and economical manner and the methods to recognize and measure assets on the financial statements must reflect this situation. The use of financial statements to monitor balanced budget legislation and as an accountability document in the public sector context must be respected in the development of the Conceptual Framework.

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, definied 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; and

(iv) Obligations to provide access to or forego future resources.

The liability definition should encompass the obligations identified in (i) and (ii), with the understanding that requirement for a past event is necessary as discussed later. We have concerns with including obligations under (iii) and (iv). In particular, with including performance obligations that may be imposed through a statutory requirement or through legislation, since governments, by their nature, have responsibilities to provide ongoing services to citizens through legislation which could be captured within the proposed concept of performance obligations. In addition, the idea of including obligations to provide access to, or forego, future resources would artificially inflate assets and liabilities of governments since an asset and a corresponding liability would be recorded. This concept of an obligation to be provided over a period of time may be better addressed through deferrals and revenue recognition.

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

The requirement for a settlement date should not be considered an essential characteristic of a liability. Timing of settlement does not determine whether an obligation to a government exists at the financial statement date; therefore, it does not support the existence of an obligation. It is an important factor only when considering measurement of the obligation and appropriate discounting methodologies.

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?

An essential characteristic of a liability should require the ability to identify an outside party to whom the obligation exists; however, it should not be necessary to identify a specific party or parties to whom the obligation exists. There are situations as noted in the consultation paper where governments will have an obligation at the financial statement date, but may not be able to identify the specific parties to whom the obligation

exists, but a class of persons entitled to the obligation may be known. In these situations, a liability should be recorded by the government in respect of these obligations even without having identified the specific person/entity given that it has been acknowledged that there is a liability to a third party.

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

We agree that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability. Without this limitation there may be liabilities recorded by the government at the financial statement date where settlement is uncertain and subsequently derecognized in a future period.

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

We support the use of approach 2 – enforceable contractual, constructive, and equitable obligations and other constructive and equitable obligations associated with exchange transactions - in determining whether an entity has a realistic alternative to avoid the obligation. This approach encompasses constructive and equitable obligations associated with exchange transactions where there is no legal basis for enforceability, but where there is no reasonable alternative to the government to avoid the obligation. However, at all times, there must be a preponderance of evidence and positive acknowledgement by the government that it is committed to settling the obligation.

Non-exchange transactions should not be incorporated as is proposed in approach 3, as it is important to respect the discretion of a government's sovereign power to avoid liability for future non-exchange transactions by cancelling future funding that has not yet been approved through legislation or by choosing to not fund what some parties may consider to be a "moral or ethical obligation." At all times, it is paramount that the ultimate assessment as to the existence of a liability rest with governments who must positively acknowledge that they will settle a liability.

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?

The occurrence of a past event obligating the government is an essential characteristic of a liability. It is not sufficient to state that a liability is a "present" obligation, as the existence of a liability is dependent on the occurrence of a past event. While the requirement of a "present" obligation may prevent including obligations that arise on the

occurrence of a future event, there may be some obligations where a past event has not occurred that could be considered as "present" obligations. In our view, these should not be captured as liabilities until the event giving rise to the liability occurs.

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?

We believe that the recognition and measurement criteria must be considered when looking at the characteristics of obligations and liabilities and would caution that making decisions regarding this issue without considering the implications on recognition and measurement may cause undesirable results when these factors are considered. As noted in our comments with respect to the existence of a realistic alternative to avoid an obligation, most government obligations will exist based on enforceable claims, such as under contractual agreements; however, there may also be some obligations that arise from moral or ethical situations that may not be legally enforceable, but would exist based on an appropriate intermediate event. Care must be taken in developing a framework related to duties and responsibilities of government to ensure that liabilities are not accrued before a government has lost discretion to avoid payment or before a government has recognized related future revenue streams that will be used to fund the future obligations. At all times, governments must acknowledge a responsibility to settle the obligation prior to a liability being recorded; and the ultimate assessment as to whether and when a liability is to be recorded arising from moral or ethical situations that may not be legally enforceable must reside with the government.

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

Enforceability of an obligation is not an essential characteristic of a liability as obligations may also arise from moral or ethical consequences that cannot be legally enforced. In the event that these can be tied to a past event and the preponderance of evidence suggests that a government has lost its discretion to avoid the obligation, these obligations should be considered liabilities of the government. This position is consistent with approach 2 discussed previously.

(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?

We believe that the definition of a liability must reflect the role that sovereign power plays with respect to government obligations, in particular when it relates to non-exchange transactions, such as transfer payments or contributions to third parties that are

dependent on annual legislative approval for continued funding. In recognition of this fact, the assessment of whether or not a liability exists should be based on legislation in force at the measurement date.

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?

We do not believe that there are other additional characteristics that 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?

The nature of certain complex public sector programs, such as social benefit programs, should be considered independently from the liability definition. Attempting to consider these programs within the current concept of liabilities could have significant implications for governments and warrants separate analysis and discussion to review the uniqueness of these programs, in particular, the need to match future expenses related to social benefit programs against future tax and/or premium revenues to be charged to finance the future payments. It would not be appropriate to recognize liabilities based on current eligibility or actuarially-derived estimates in the current year's financial statements if the future revenue streams are not also recognized. In our view, it would be preferable not to record any future year amounts related to social benefit payments but rather to recognize the amounts as they are payable and receivable in the future.

Specific Matter for Comment 11:

(a) Should revenues and expenses be determined by identifying inflows and outflows which 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)?

We support the use of a revenue and expense-led approach determined by identifying inflows and outflows applicable to the period. We believe that this approach is consistent with the budgetary framework under which governments are held accountable and is most appropriate in a public sector context. The recent global economic crisis and recovery has emphasized the need for balanced or improved budget predictions in the public sector and has resulted in increased accountability in the public sector for spending measured against budget. While one may argue that budgets are used in the private sector where standards have recently put increased focus on the asset/liability approach, the key difference is that private sector budgets are not generally published and

performance is assessed on various factors one of which is net income; however, net equity as a proxy of an entity's worth is also assessed. In the public sector, given the ability to tax and the capacity to raise debt financing, the use of fair value measure for assets and liabilities has less relevance; whereas achieving budgeted revenues and expenses is one of the key performance metrics against which governments are held to account. A focus on revenue and expense provides greater predictability within this environment and provides a better measure of a government's effectiveness and efficiency in delivering services to citizens. The emphasis on revenue and expenses and inflows and outflows better supports accountability as to whether the government's established tax rates support delivery of services to citizens. An asset and liability-led approach could introduce additional volatility resulting from changes in the value of assets and liabilities that cannot be predicted by governments and do not provide useful information for assessing a government's performance related to its key objectives of providing effective and efficient service delivery to citizens. We would also encourage IPSASB to consider the concept of deferred inflows and outflows in support of the approach to report inflows and outflows applicable to the period.

(b) What arguments do you consider most important in coming to your decision on the preferred approach?

As noted in our comments on the previous question, we believe that the budgetary framework under which governments are held accountable is the key factor supporting our preferred approach. The revenue and expense-led approach provides better reporting in a service delivery environment as it focuses on the statement of operations and the effectiveness of government spending to provide services to the public. It also provides relevant information on taxes and revenues earned in the year and how funds were spent allowing for better information for users to assess if the taxes earned were sufficient to cover expenses incurred during the period. As noted above, it is also an appropriate model for public sector entities operating under balanced budget legislation. An asset and liability-led approach, where all changes in assets and liabilities are recognized through the statement of operations, introduces unrealized gains and losses to the statement of operations that would not provide useful information for assessing a government's performance with regard to service delivery performance.

Specific Matter for Comment 12:

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

As noted in our discussion regarding the revenue and expense-led approach, we believe that transactions with residual/equity interests should be excluded from revenues and expenses of the period as they do not provide useful information to assess current government performance. This view is consistent with the nature of a public sector

operating environment where governments are held accountable to the public for the effective use of current financial resources to provide service to the public.

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

We support limiting the definitions of revenue and expense to include specific operations-type activities, as we believe it is necessary in applying a revenue and expense-led approach that permits users to evaluate a government's service delivery performance.

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 revenue and expense?

We do not believe that there are any additional characteristics that are essential to the development of definitions of revenues and expenses.

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

As we have noted in our previous comments, we believe that the public sector operating environment, which includes accountability for the effective delivery of services to the public and balanced budget legislation that exists in some jurisdictions, must be considered in determining the definitions of revenues and expenses.

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.

In order to implement a revenue and expense-led approach that allows for the allocation of inflows and outflows to the applicable period, we believe that deferrals need to be identified on the statement of financial position. We support the approach of defining deferred inflows and deferred outflows as separate elements rather than including with the definition of assets and liabilities or net assets and net liabilities. As noted in the CP, identifying deferrals as separate elements will permit IPSASB to continue to use a more

traditional definition of assets and liabilities which is better understood by financial statement users. We also believe that defining deferrals as separate elements will provide greater transparency as they will be presented separately on the statement of financial position.

(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?

We believe that the proposed definitions of a deferred outflow and deferred inflow set out in paragraph 5.8 are appropriate and complete. We agree with the proposed term "net assets" to differentiate these deferred items from other transactions that do not result in changes in the net asset amount.

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 IPSASB needs to consider in determining the concept of net assets/net liabilities?

Overall, we feel that for a senior government the net assets/net liabilites represent a residual amount. As a residual, we do not believe that the concept of ownership interests is applicable in a government context except for limited circumstances where a GBE or government subsidiary has a minority investor whose interest should be reflected as a separate component in the statement of financial position.

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?

We do feel that transactions with residual/equity interests should be defined as separate elements.

Specific Matter for Comment 17:

(a) Should recognition criteria address evidence uncertainty by requiring evidence thresholds; or by requiring a neutral judgement whether an element exists at the

approach on the measurement attribute?

We refrain from commenting on the proposals for addressing evidence uncertainty as we feel that it is necessary to obtain an understanding of the specific thresholds which would be applied and whether certain exclusions would exist. As we have noted previously in our comments on the definition of assets and liabilities, we have concerns with introducing broad definitions that capture assets such as Crown land, forest and water rights, or mineral resources, in particular if they would also qualify for recognition. We believe that recognition of these resources would introduce significant challenges for governments in developing a methodology for measurement, with little usefulness to financial statement users. We would support looking to a government decision as indication of the existence of an element over strict evidence thresholds.

(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?

As noted in response to the previous question, we find it difficult to provide specific comments on thresholds for recognition without understanding how they would be applied under the proposed asset definitions. However, if a threshold or situational approach is used, we are of the view that it will likely be necessary to establish different thresholds for assets and liabilities, reflecting the nature of each element.

Specific Matter for Comment 18:

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

We believe that it is necessary to establish separate criteria for derecognition. These criteria may be similar to the criteria for initial recognition, but we believe that they must be based on the existence of an event or transaction that results in the derecognition. Without a specific event or transaction to trigger derecognition, each element would need to be reviewed at each financial statement date to determine whether the criteria for recognition continue to be met.

Specific Matter for Comment 19:

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

As we have noted throughout our comments, we believe that recognition criteria must be considered and integrated into the definition of elements as they are integral to determining whether an element exists and the impact of that decision.

NEW ZEALAND INSTITUTE OF CHARTERED ACCOUNTANTS

20 June 2011

Ms Stephenie Fox
The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto
Ontario M5V 3H2
CANADA

Submitted to: www.ifac.org

Dear Stephenie

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

The Financial Reporting Standards Board (FRSB) of the New Zealand Institute of Chartered Accountants is pleased to submit its comments on the IPSASB's Consultation Paper *Elements and Recognition in Financial Statements*.

We would like to thank the IPSASB for devoting resources to the development of this Consultation Paper and encourage the IPSASB to continue providing a forum for international debate on these issues.

We have two key comments. First, we consider that the definition of assets and liabilities should be generic and allow for the identification of a wide range of rights and obligations, including the right to tax and social benefit obligations, but the definition should be independent from recognition criteria. Secondly we support an 'asset and liability-led approach' to the determination of revenues and expenses.

Our detailed comments are set out in an Appendix to this letter.

If you have any queries or require clarification of any matters in this submission, please contact Joanne Scott (joanne.scott@nzica.com) in the first instance, or me.

Yours sincerely

Joanna Perry
Chairman – Financial Reporting Standards Board

E: joannaperry@xtra.co.nz
Tower Building
50 Customhouse Quay
PO Box 11342
Wellington 6142
New Zealand

Appendix – FRSB comments on the Consultation Paper Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements

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?

1. In relation to question 1(a) we support a definition of an asset that covers all three types of benefits listed.

2. In relation to question 1(b) we consider that either approach could be used but prefer approach (ii). The critical issue is that the notion of service potential as an asset is included in the Framework. This can be achieved under both options (b)(i) and (b)(ii). In the case of option (ii) it could be achieved by stating in the Framework that the term economic benefits is to be read as having the same meaning as service potential or by using the argument that service potential is a subset of economic benefits (as per the argument set out in paragraph 2.24 of the Consultation Paper (CP)). Regardless of which approach is taken we consider that the discussion of assets in the proposed Framework should highlight that public sector entities may hold assets because of their ability to deliver goods and services in accordance with the entity's objectives, or to generate net cash inflows.

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?

3. In relation to question 2(a) we support an approach that takes account of both control and access to rights, including the right to restrict or deny others' access to rights. However, risks and rewards – while subordinate to the other two approaches canvassed should be acknowledged as an indicator of control and access to rights. Care needs to be taken when discussing rights of access to assets, as rights of access may, in themselves, be assets. The FRSB believes the first step is to identify the nature of the asset under consideration and then decide if that asset is an asset of the entity.

4. Although we support using access to rights as a means of associating an asset with an entity, we note that it can be difficult to do this without reference to control (hence our response that it may be necessary to take account of both control and access to rights). If an entity has access to benefits, including the right to restrict or deny access to others), then it also has the ability to utilise the present service capacity inherent in those benefits.

5. In relation to question 2(b) we consider that an enforceable claim to benefits, or ability to deny, restrict, or otherwise regulate others' access, is necessary, but is not sufficient on its own to demonstrate an entity's link with an asset.

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?

6. We do not consider that identification of a past event is required in order for an asset to exist. The question of whether or not an asset exists should be answered by reference to present circumstances. However, we acknowledge that a past transaction or event may be useful as an indicator that an asset exists. We therefore support the statement in the CP that a past transaction or event may be regarded as "an indicator of evidence supporting the existence of a present resource" (paragraph 2.47).

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?

7. We consider that the identification of assets (through application of the definition of an asset) should be independent of recognition criteria. We consider that a government's rights/powers to tax and levy fees are assets. However, such assets might not qualify for recognition in the financial statements. The right to tax is a different asset from a taxation receivable. A taxation receivable may exist only once an event (such as the exercise of the rights/powers) has occurred. The recognition of any such taxation receivable would be subject to recognition criteria, as would rights/powers to tax and levy fees.

8. We generally support the ideas presented in paragraphs 2.52 and 2.53 of the CP. However, rather than saying that such rights would still have measurement hurdles to overcome, we would prefer to say that, as with any assets, they would be subject to recognition criteria to determine whether they are recognised in the financial statements. If entities have significant unrecognised assets this could raise disclosure issues.

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?

9. We have not identified any additional characteristics or other relevant issues.

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?

10. Consistent with our comments on specific matter for comment 4, we consider that liabilities should be defined generically and should not be limited to items that would be recognised in financial statements. We consider that the critical question is whether there is a present obligation.

11. To the extent that an entity has no realistic alternative to avoid an outflow of economic benefits in settlement of the types of obligations described in (a)(i) to (iii), we agree that these types of obligations are liabilities. However, we consider that if the words "present obligation" are used in the definition of a liability, there is no need to refer to the ability, or inability, of an entity to avoid the obligation.

12. We are unable to provide a definite answer to 6 (a)(iv) as we are not sure what is being proposed. We agree that it is appropriate for the framework project to consider whether certain future obligations meet the definition of a liability. We consider that only present obligations should meet the definition of a liability and that any application of the definition of a liability to obligations to provide access for example, should focus on whether there is a present obligation.

13. In relation to specific matter for comment 6(b) we consider that a particular settlement date is not an essential characteristic of a liability. Settlement date may be relevant in the context of a contract, but it is not always relevant or necessary. However, existence of a settlement date may be an important indicator of a liability because if an entity has complete discretion to settle an obligation at any time in the future, it effectively can choose whether or not to settle the obligation. In such circumstances, the obligation is unlikely to be a liability.

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?

14. In relation to 7(a) we do not consider that the ability to identify a specific party(ies) outside the reporting entity to whom the entity is obligated should be considered an essential characteristic in defining a liability. The definition of a liability should require that there be an outflow of resources (from which an entity cannot realistically withdraw) but we do not consider that it is essential to identify the external party(ies) that will receive that outflow of resources.

15. In relation to 7(b) we agree that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability.

16. In relation to 7(c) we support option (c) in paragraph 3.28 of the CP but have reservations about the emphasis on constructive obligations.

17. Consistent with our comments on the definition of an asset, we support a broad definition of a liability, whilst acknowledging that some types of liabilities will be unlikely to meet recognition criteria.

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?

18. Consistent with our response on specific matter for comment 3, we consider that a past event may indicate the existence of a present obligation but it is not an essential component of the definition of a liability.

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 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?

19. In relation to specific matter for comment 9(a), and consistent with our comments in relation to the definition of an asset, we support the perpetual obligations view outlined in the CP. The CP discusses how the nature of obligations can change over time, with future events crystallising the timing of outflows and the claimants. We agree that this is an appropriate way of describing the life cycle of some liabilities. However, we would also encourage the IPSASB to explicitly acknowledge that only some obligations will (i) meet the definition of a liability and (ii) meet the criteria for recognition in the financial statements.

20. In responding to specific matter for comment 7(b) we expressed the view that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability. Our response to specific matter for comment 9(b) is "No", given that paragraphs 3.50 – 3.58 of the CP explain 'enforceability' as a **present** capacity of claimants to enforce their claims against the entity. However, we note that in many cases those obligations that are enforceable will also be obligations that an entity has no realistic way of avoiding. However, we consider that there are some obligations which will not presently be enforceable but which should nevertheless be identified as liabilities (even if they are not recognised in the financial statements).

21. With regard to specific matter for comment 9(c) our comments on 9(a) may be relevant. If a generic definition of a liability focusing on unconditional obligations is adopted, some obligations of governments would be identified as liabilities, but not recognised because they do not meet recognition criteria. If a government's policies changed, some of these obligations might cease to be liabilities.

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?

22. We consider that the notion of unconditional obligations is essential to the development of a liability definition. We acknowledge that public sector entities have a broader range of obligations than private sector entities, particularly in respect of social benefits. As discussed in the preceding matter for comment, a generic definition of a liability could lead to some of these broader obligations being identified as liabilities. Recognition would remain a separate issue.

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?

23. We consider that revenues and expenses should be determined by an 'asset and liability-led approach'. We are strongly of the view that assets and liabilities should be defined in relation to economic resources and economic obligations and that revenues and expenses should reflect changes in those resources and obligations.

24. We note that some of the issues being raised today are the same as those raised by constituents when the FASB first sought feedback on the definitions of elements in the early 1970s. At that time some constituents expressed concern that if items that do not meet the definition of an asset are included in expenses of the current period, they may distort the income of other periods in which the items more properly belong. This issue is still being debated in the context of the GASB financial resources approach with outflows of resources that are intrinsically related to future services but which do not meet the definition of an asset being one of the items that may give rise to a deferred inflow.

25. We agree that it is important that financial statements provide information about such transactions, but we do not agree with the recognition of such items as deferred inflows and outflows. We believe that the most conceptually defensible approach is to develop robust definitions of assets and liabilities and then consider how to address any information needs that are not satisfied following application of those definitions, through perhaps presentation and disclosures.

26. Although the term 'asset and liability-led approach' has been used by a number of standard setters, we would like to stress that we do not consider that this approach is concerned predominantly with reporting financial position. We consider that revenues and expenses comprise the financial effects of an entity's current period accomplishments and that the 'asset and liability-led approach' gives equal importance to the reporting of financial position (a "stock" concept) and financial performance (a "flows" concept). The two views simply reflect different perspectives on the financial effects of an entity's current period accomplishments.

27. We are concerned with the focus of the 'revenue and expense-led approach' on achieving 'inter-period equity', and its adoption of the view that "the principle that taxpayers pay only for the services they receive and not pass on obligations to future taxpayers should ground any measure of financial performance". Specifically, we are concerned that this approach is based on a value judgement about who should pay for services rendered in a particular period and a direct link between funding decisions and

recognition of liabilities. We acknowledge that inter-period equity considerations are important for governments and that financial statements may be used in making assessments of inter-period equity. However, this does not mean that notions of inter-period equity should influence financial reporting element definitions.

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?

28. In relation to specific matter for comment 12(a) we consider that transactions with residual/equity interests should be excluded from revenues and expenses. We support the view outlined in paragraph 4.41 of the CP that contributions intended to be an investment in the initial operating capacity of the entity or, subsequently to increase it, should be excluded from revenues. We also support the related treatment of distributions outlined in paragraph 4.41 (that is, distributions intended to reduce operating capacity or intended to be a return on the owners' investment should be excluded from the definition of expenses). We consider that this approach is suitable for all types of public sector entities. We therefore refute the suggestion in paragraph 4.42 that this approach is appropriate only when net assets/liabilities are similar to a private sector equity interest.

29. In relation to specific matter for comment 12(b) we consider the definitions of revenue and expense should include inflows from all transactions and events other than transactions with residual/equity interests. We do not support limiting the definitions to specific types of activities associated with operations. Much of the current complexity in financial reporting revolves around the presentation of gains or losses in financial statements.

30. We consider that all gains and losses should be presented in a single comprehensive statement of financial performance. This removes the need to distinguish between revenue from operations and other revenue and removes the need for rules regarding classification of gains and losses. Our comments here are consistent with earlier comments to the IASB in relation to the presentation of financial statements. We have previously encouraged the IASB to remove the category of other comprehensive income as soon as solutions can be reached for items presently classified there.

31. We note that historically there has been confusion within financial reporting standards regarding the meaning of operating activities and ordinary activities. Although entities will always have an interest in providing users with information on the results of ongoing activities as opposed to one-off events, this is a presentation and disclosure issue and should not drive the definitions of elements.

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?
(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?

32. We have not identified any other characteristics or issues.

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?

33. Consistent with our response to specific matter for comment 11 we have not responded to this question. We do not support the identification of deferred outflows and deferred inflows as elements of financial statements.

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?

34. In relation to specific matters for comment 15(a) and (b) we consider it essential that the proposed Framework acknowledge the existence of ownership interests in the public sector. In some cases there may be no identifiable ownership interest. For this reason we consider that net assets/net liabilities should be regarded as a residual amount. In many cases this residual will represent an ownership interest.

35. We support the approach set out in paragraph 5.25(a) of defining net assets/net liabilities and treating any specific ownership interest as a sub-classification of net assets.

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?

36. In relation to specific matter for comment 16(a) we do not consider that residual/equity interests should be defined as separate elements. We disagree with the assertion in paragraph 5.33 that if a residual amount approach is taken to net asset/net liabilities that it would be inappropriate to separately identify and represent the existence of transactions that impact on that residual. We consider that a residual amount approach is the most appropriate because there will not be an identifiable ownership interest in every case. If a residual amount approach is adopted, we do not consider that this precludes acknowledgement of ownership interests. However, we do not consider that ownership interests should be defined as a separate element.

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?

37. In relation to specific matter for comment 17(a) we support requiring a neutral judgment whether an element exists at the reporting date based on an assessment of all available evidence (as discussed in paragraphs 6.4 to 6.19 of the CP).]

38. We note that, in the context of its Liabilities project, the IASB has considered the difficulties that can arise in applying this approach to events with uncertain outcomes such as lawsuits. The IASB has decided tentatively to specify that, in situations of uncertainty, existence of the obligation is met if the available evidence indicates that it is *more likely than not* that a liability exists. We note that although the IASB's Framework project will be informed by the thinking on this project, the IASB's decision has been made in the context of developing an IFRS rather than at the Framework level.

39. We consider that the Framework should provide guidance for the development of standards, and should not attempt to address standards-level issues. This is consistent with our view that the definitions of elements should be broad and that definitions and recognition criteria should be addressed separately.

40. Specific matter for comment 17(b) is not applicable based on our response to (a).

Specific Matter for Comment 18

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

41. We support the use of the same criteria for derecognition as for recognition. We acknowledge that development of standards level guidance for complex transactions can be challenging but see no reason why there should be any difference between recognition and derecognition in the Framework.

Specific Matter for Comment 19

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

42. We consider that recognition criteria should be separate and distinct requirements. Our comments on specific matters for comment 4 and 9 reflect our views on this matter.

Other comments

43. We recognise that this is a substantial project and that the IPSASB is working towards completion of a final Framework in May 2013. We encourage the IPSASB to leave open the possibility of issuing an ED of the full Framework once all the separate phases have reached ED stage.

Technical Director
IPSASB/ IFAC
Stepheniefox@Ifac.org

Conceptual Framework for General Purpose Financial Reporting
By the Public Sector
Due 6-15- 2011

Comments by: Dr. Joseph S. Maresca CPA, CISA

Colleagues,

I thank you for the opportunity to critique this framework on financial reporting. The details follow:

Background:
General Purpose Financial Statements focus on the various aspects including the financial portrayal of past events. The objective of financial reporting is to provide useful information to a variety of stakeholders including:

o entities for the use of resources economically
o cost accumulation
o taxes to meet services and provider needs

Assets point to the right to receive benefits or an intangible resource. The issuance asks the question as to whether or not an asset exists if no cash is generated per se. Assets can remain within the earth for centuries although no cash is generated. The relevant event is discovery, the existence of provable reserves and investors to provide capital for the extensive exploratory and extraction costs.

Is there an asset when economic benefits are received via unconditional rights? How should unconditional risk be dealt with ?

Is the reporting entity asset under control of the government or other entity? What are the risks, access to rights, ability to deny access and claims enforcement?

Customarily , rights are accessed as a result of a statute with rule structures, qualification guidelines and funding sources like employer/employee deductions, self-employment taxes and other inflows to pay for the services. Sometimes " sin taxes" are another source of funding for unhealthful dietary choices.

Does an asset arise from a past transaction or event? If so, is the mandate funded ?

This is one of the most contentious areas of social benefits. The national government may promulgate various mandates for services that the States must provide for without the requisite funding in place.

Are taxes an inherent right of the government? Without taxes, there could be no paid for public service except through voluntarism like voluntary fire departments in rural communities.

Liabilities are in the nature of an economic obligation, unconditional obligation with performance requirements and payment settlement dates.

The Statement addresses the issue of financial performance through the prism of net changes in economic resources or obligations like the Asset/Liability approach or the revenue/expense outflow approach.

The Statement discusses broadening the asset/liability elements to include deferrals. i.e. Deferred inflows/ outflows are treated as separate elements. The disclosure is necessary to preclude delaying the recordation of critical accounting events indefinitely or using "catch all" accounts to obscure a more complete financial picture from emerging.

Critique

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The IPSASB/ IFAC has identified very key elements of financial disclosure for readers of the financial statements pertinent to a plethora of constituencies in the private sector and government.

Comment 1- An asset relates to service potential , net cash inflows/ outflows, rights to receive resources or economic benefits. I agree.

Also, public infrastructure like roads, tunnels , bridges etc. have a clearly definable connection to economic well being because without these public assets- economic activity could never commence in any meaningful form.

Comment 2- Assets of an entity are related to control, risk, access to rights and claims enforcement mechanisms. I agree.

Comment 3- " " past events or present resources are part of the definition. I agree.

Comment 4, 5 - There is a concommitant power to tax or levy with regard to maintaining the asset or the rights to the same. I agree.

Comment 6- There are obligations to transfer benefits in classic liabilities at a settlement date which is known or easily determinable. I agree.

The benefit qualifications are creatures of statute. Benefits are or may be matched against contributions by employers, employees or even small business owners.

Comment 7- 11 A defining characteristic of the liability is its unavoidability. Generally, I concur. Fiscal responsibility would require that funds earmarked for the general public are not spent in other discretionary areas like defense.

Social welfare agencies of the government do possess the power to tax activities or behaviors that detract substantially from the public health and cause unnecessary/avoidable health encounters for the poor in particular. This comes under the umbrella of "sin taxes" or taxes on luxury items which may or may not impair health.
i.e. cigarettes, marijuana (in some jurisdictions), alcohol, junk food, high content sugar food, inorganic chemistry food or food made substantially in a lab

Comment 12 Residual interest may be separately disclosed from revenues and expenses to define more clearly a residual benefit and stakeholders

for the same.

Comment 14, 15- Deferred inflows and outflows should be disaggregated to provide more complete financial disclosure. This helps to clarify the rights, duties, obligations and recourse to particular stakeholders of an entity. 1)

Comment 17- The relevant threshold is asset/liability materiality.

Comment 18- Where there is recognition-there should be derecognition.

Comment 19- Recognition is integral to the definition of an element.

References:
1) GASB- Financial Reporting of Deferred Outflows/Inflows
http://www.tkw.com/App_Content/files/Summary%20of%20E%20D%20%20-%20Deferred%20outflows.pdf

The Canadian Institute of Chartered Accountants
277 Wellington St. West
Toronto, ON M5V 3H2

L'Institut Canadien des Comptables Agréés
277, rue Wellington Ouest
Toronto (Ontario) M5V 3H2

Tel/Tél. : 416 977.3222 Fax/Téléc. : 416 977.8585

PSAB CCSP
Public Sector Accounting Board
Conseil sur la comptabilité dans le secteur public

June 7, 2011

Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto, Ontario M5V 3H2 CANADA

Re: PSAB Staff Comments on Consultation Paper (CF-CP2) "Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements"

Thank you for the opportunity to provide input on the proposals in this Consultation Paper (CF-CP2). We feel that this is the critical piece of the conceptual framework project and potentially the one where there will be the most difficulty in garnering consensus. In particular, a decision regarding the approach to financial performance for public sector entities has the potential to fundamentally re-shape public sector generally accepted accounting principles (GAAP) depending on the direction chosen.

Responses to the Specific Matters for Comment in CF-CP2 are set out in Appendix A to this letter. Additional comments about the CF-CP2 by paragraph are provided in Appendix B.

Further, we wish to encourage the IPSASB to integrate the key characteristics of the public sector more fully into the final framework.

The key characteristics of the public sector are the primary reason that the IPSASB chose to do its own conceptual framework project rather than leveraging and converging with the evolving IASB-FASB private sector conceptual framework. Unique aspects of the public sector are mentioned in the CF-CP2 but their implications are not simply and fully set out. The "Key Characteristics of the Public Sector" Exposure Draft approved by the IPSASB at its March 2011 meeting is a critical, overarching umbrella document that needs to be explicitly linked to all phases of the framework. It is important that Phase 2 content not be finalized until such cross-references are incorporated. The key characteristics document should be the touchstone document in the CIA[1] parts of the IPSASB's timetable for the conceptual framework.

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[1] As defined in the IPSASB Conceptual Framework Timetable, CIA means: "consider issues arising from other phases of the project". It is scheduled to occur in June 2012 (Phase 1) and Dec 2012 (Phases 2-4).

We appreciate the opportunity to comment on this Consultation Paper. It is the most fundamental piece of an international public sector conceptual framework. We are very supportive of your conceptual framework initiative and wish you success in integrating this piece of the framework with the other phases and the key characteristics document.

Please note that these comments are the views of PSAB staff and not those of the Public Sector Accounting Board (PSAB). In addition, the comments made in this response are generally consistent with the existing conceptual framework in the Public Sector Accounting (PSA) Handbook. PSAB has initiated a project to review the concepts underlying financial performance in that framework and may be in a position to share developments in that project with the IPSASB in the future.

Sincerely,



Martha Jones Denning, CA
Principal
Public Sector Accounting

Appendix A
Responses to Specific Matters for Comment

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?

Yes. But for unconditional rights to receive resources, it would seem most appropriate to only include those cases where the entity has paid for the unconditional promise or the rights develop an acknowledged market value while being held. When the unconditional promise to receive benefits is coupled with an equal unconditional promise to transfer economic resources to the supplier in the future, neither the asset nor the liability aspects of such executory contracts should be recognized.

Consider an unperformed executory contract to purchase a fire truck. Neither the fire truck nor the obligation to pay for the fire truck would be recognized. However, the executory contract itself might have value and that value may change before the contract is performed. The value of such a contract may have changed since the contract was signed – much liked a derivative contract, and it may be appropriate to recognize such value changes. Once a choice has been made to recognize such value changes for derivatives, then conceptually, it is difficult to exclude them for other contracts. However, we recognize that there are practical difficulties in applying such a concept to many executory contracts. In contrast to derivatives, there may not be an active market for such contracts so monitoring and recognizing value changes may be difficult and costly. And, there is typically less variability associated with such contracts, so the information that would come from re-measuring these contracts at each financial reporting period may not be that meaningful.

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

"Economic benefits" alone should be used. This term encompasses the concepts of both future net cash flow and future service potential. The benefit of future service potential is economic in nature as described in CF-CP2.

The two concepts don't need to be articulated separately. In cases where they have historically been set out separately, it is likely that the framework was an adaptation of a private sector

framework and the public sector nuances were more in the nature of add-ons so that the differences and changes were apparent. In a purely public sector framework, it can be recognized that net cash flows and future service potential are both types of economic benefits and only the term "economic benefits" can be used to encompass both.

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?

A control approach should be used to associate an asset with a specific entity.

While it is true that control may be difficult to apply in some cases because it requires judgment to ascertain the existence of control, indicators of control could be developed to assist in the judgment process. In addition, although control may be seen as applying to an asset as a whole, in reality the concept can be applied to individual rights that make up the whole. This idea can be illustrated by a components approach such as that taken in the Canadian PSA Handbook Guideline PSG-5, *Sale-Leaseback Transactions*[2] Further, the existing asset definition used by the Financial Accounting Standards Board (FASB) in the U.S. is a control-based definition. And yet the possibility of assets being separable into components parts is recognized in FASB CON 6, Appendix B, paragraph 185, which states:

> The definition of assets focuses primarily on the future economic benefit to which an entity has access and only secondarily on the physical things and other agents that provide future economic benefits. Many physical things and other agents are in effect bundles of future economic benefits that can be unbundled in various ways, and two or more entities may have different future economic benefits from the same agent at the same time or the same continuing future economic benefit at different times. For example, two or more entities may have undivided interests in a parcel of land. Each has a right to future economic benefit that may qualify as an asset under the definition in paragraph 25, even though the right of each is

[2] "The components approach assumes that the sale and leaseback can be separated objectively by comparing the terms and conditions of the sale-leaseback to its related fair value information. The comparison enables each component part of the transaction to be accounted for according to its economic substance. The components of a sale-leaseback transaction include the property, lease liability, revenues and expenses (including gains and losses), and any other assets or liabilities that may result from the transaction." PSG-5, *Sale-Leaseback Transactions*, paragraph 6.

> subject at least to some extent to the rights of the other(s). Or, one entity may have the right to the interest from an investment, while another has the right to the principal. Leases are common examples of agreements that unbundle the future economic benefits of a single property to give a lessee a right to possess and use the property and give a lessor a right to receive rents and a right to the residual value. Moreover, a mortgagee may also have a right to receive periodic payments that is secured by the leased property.

A risks and rewards approach requires an entity to dissect certain arrangements for the purposes of identifying the individual risk and rewards to make a determination of whether an asset is associated with an entity. It requires that an entity make an assessment of all related factors to determine whether the asset is of the entity. Without the anchor of control, it could result in range of possibilities given the varying degrees of risks and rewards associated with an asset.

We feel that the concepts of control and risks and rewards are not completely separable. Doesn't an entity that controls an asset have access to the rights and rewards of the asset and also bear the risk of loss associated with the asset? Is it not possible for an entity to control only part of a bundle of future economic benefits? We feel that the concepts used to associate an asset with an entity should be fairly comparable to the concepts used to include an entity in a group reporting entity. However, the asset definition will need to make the decision regarding the specifics of association at the concepts level whereas the specifics of association for the reporting entity have been left (in the Phase I ED) for consideration at the standards level. The high level concepts in the Phase I ED are "the authority and capacity to direct the activities of other entities" and "the capacity to benefit or be exposed to a financial burden or loss". We agree with this approach for the entity and feel that a similar approach is appropriate for associating an asset with an entity too. This approach might eventually result in a control approach to the entity as well at the standards level. For example, the PSA Handbook defines control for the purposes of its reporting entity standard as:

> "Control is the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities."

In associating an asset with an entity, IPSAS 23 states:

> "**Control of an asset** arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit."

This IPSAS 23 definition can be built on for use in the new framework. It does not encompass the risk of loss that may be

associated with control of an asset and that risk aspect needs to be added. It also does not recognize that the future economic benefits associated with an asset may be unbundled and controlled by more than one entity. These refinements might be appropriate in developing the asset definition for the public sector conceptual framework.

(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?

We feel that the requirement for an entity to have a legally enforceable claim in order to control access to the benefits may not, of itself, be considered an essential characteristic of an asset. However, the enforceability of the rights may be an appropriate indicator for linking a resource and a specific entity. See comments regarding "indicators of control" in (a) above.

The question in Matter 2 (a) uses the term "associate" and the question in Matter 2 (b) uses the term "link". We are not sure if the intent for each term is the same. Does "associate" mean that the concept will be included in the definition of an asset and "link" mean that the concept will be an indicator of whether an asset is associated with an entity? Or do they mean the same thing?

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

We do not suggest additional requirements. Rather we suggest development of indicators of control when control is defined as something that encompasses the following ideas:

> **Control of an asset** arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives, can exclude or otherwise regulate the access of others to that benefit, and is exposed to any risk of loss related to the asset.

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?

Yes – it is sufficient to state that an asset is a "present" resource.

However, the occurrence of a past transaction or event may be crucial evidence that prompts an entity to evaluate whether it has a present resource resulting from that transaction or event. Perhaps indicators that a public sector entity should consider in evaluating if it has a present resource to be recognized as a asset might be an option here (see same suggestion for liabilities below).

We do not believe that the role of a past transaction or event should be eliminated from the guidance surrounding the asset definition but do not believe that it is a defining characteristic of an asset.

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?

Public sector entity rights and powers, such as the power to tax, only have the potential to create assets for the public sector entity when they are exercised. The power to tax represents an intention to levy tax in the future. It does not represent a present resource. An asset does not exist yet. Nor has there been a past transaction or event that would prompt an entity to look for the existence of an asset – that would only happen once the tax has been authorized and levied. The power to tax or license represents an ability to obtain assets by imposing taxes or fees but is not in itself an asset.

A power to tax or license is not a present economic resource because such powers are not capable of producing inflows of cash, cash equivalents or goods and services to the public sector entity nor are they yet capable of providing services to the entity or its constituents. Unless it has been exercised, the power to tax or license cannot be used for the production of goods, provision of services or consumption by the entity. It cannot be used to purchase goods or services or give an entity the right to receive goods or services or the right to use others' assets.

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?

No.

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

Consider possible linkages with the Exposure Draft, "Key Characteristics of the Public Sector", approved at the March 2011 meeting. For example, consider the effect of regulation and whether this government power has the ability to create assets or liabilities for the government. We don't believe it does but feel that explicit cross referencing with the Key Characteristics ED

would strengthen the substance of the framework as one designed for the public sector. Perhaps each document issued could have a table that indicates the implications of the key characteristics for the principles set out in the document. This summary table could then be used when all of the pieces of the framework are put together to develop a matrix that outlines all of the implications of the key characteristics of the public sector.

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.

The definition of a liability should definitely include obligations to transfer benefits, defined as cash and other assets, and the provision of goods and services in the future, and performance obligations. The other two suggested types of obligations are more problematic and their inclusion in the scope of a public sector definition of a liability may not be appropriate. We share some of the concerns raised in the CP regarding their inclusion.

For the reasons set out in paragraphs 3.18-3.20, we do not feel that there is theoretical support for the definition of a liability to cover obligations to provide access to or forego future resources. In the example cited, it would seem that the government should recognize revenue for the lump sum sale of the right to charge a toll for use of the road.

We are also concerned with the notion that the liability definition could cover unconditional obligations, including unconditional obligations to stand ready to insure against loss (risk protection). We believe that the last sentence of paragraph 3.14 is correct to state that in the public sector in particular it may be difficult to draw a distinction between a conditional obligation and a stand-ready unconditional obligation.

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

Yes – the requirement for a settlement date should absolutely be an essential characteristic of a liability. One of the aspects that

distinguish a liability from equity is the requirement for a settlement date. We feel that inclusion of the phrase "settlement on the occurrence of a specified future event" in the definition of a liability would address those situations, such as lawsuits, where the settlement date is not yet known.

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?

Yes. The obligation to sacrifice economic benefits must be to a third party. It is necessary that the entity or individual exist at the financial statement date. It is not necessary, however, for the public sector entity to know the specific identity of the party or parties involved, as the obligation may be to the public at large or to a specific group of recipients.

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

Yes. Liabilities are present obligations that embody a duty or responsibility to others, leaving a public sector entity little or no discretion to avoid settlement of the obligation. Having little or no discretion means that a government has no realistic alternative but to settle the obligation. The obligation does not depend on future actions of the government or other transactions or events. The government has given up its freedom to make further choices, judgments and decisions related to the obligation. The absence of a realistic alternative to avoid the obligation is a crucial line in the sand that helps determine when a public sector entity has a liability.

Discretion is the ability to make individual choices, judgments or decisions. Decisions such as budgeting for purchases or transfers and future program expenditures are not present obligations. In these circumstances a public sector entity is not bound to a particular course of action, as the entity has realistic alternatives to change or avoid the obligation through its own actions.

(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?

We agree with approach (c) in paragraph 3.28. The application of constructive obligations must be extended to non-exchange transactions. The key is when an entity cannot realistically

withdraw from/avoid an obligation – and this is not conditional on whether the transaction is exchange or non-exchange in nature. However, we acknowledge that determining when discretion has been lost to avoid an obligation in relation to a non-exchange transactions may not be easy.

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?

We believe that it is the existence of the obligation at the financial statement date (i.e., a "present" obligation) that is the key factor.

Similar to our response to Matter 3 above, the occurrence of a past transaction or event may be crucial evidence that prompts an entity to evaluate whether it has a present obligation resulting from that transaction or event. Perhaps indicators that a public sector entity should consider in evaluating if it has a present obligation to be recognized as a liability might be an option here, as was suggested for an asset above. We do not believe that the role of a past transaction or event should be eliminated from the guidance surrounding the liability definition but do not believe that it is a defining characteristic of a liability.

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?

We believe that a government's responsibilities should only be considered obligations of the entity when they lead to enforceable claims. Government responsibilities change. Governments change on a regular basis and so do the programs they establish. Even those responsibilities considered to be "untouchable" are just programs and they can be changed or cancelled, albeit with some political fallout. The existence of a program/responsibility is not sufficient evidence of an obligation. At a minimum, some exercise of authority is required for a government to lose its discretion to avoid an obligation. Indicators such as those suggested in response to Matter 8 might help in ensuring that "perpetual obligations" are not even considered for recognition.

The measurement difficulties for "perpetual obligations" would likely be insurmountable and it would be difficult for such obligations to meet the qualitative characteristics of items to be reported in financial statements.

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

Yes, enforceability of an obligation is important. But we do not believe that it should be identified as an essential characteristic of a liability. It should instead be part of the guidance that explains what "no realistic alternative to avoid the obligation" means.

Enforceability should go beyond the contractual to include legal enforceability through other concepts such as promissory estoppel.

The inclusion of enforceability serves to emphasize the binding nature of the obligation and thus supports the contention that an entity has a liability. Enforceability often includes the notion of consequences for non-performance – explicit or implicit. Implicit consequences are those that are understood because of past experience between the parties to an obligation, or past behaviour of the obligor, and that have resulted in sanctions in the past so they would serve as well as explicit consequences to emphasize the binding nature of the obligation. Without such explicit or implicit consequences, a binding right is not obtained nor a binding obligation undertaken and performance requirements alone may merely reflect the intentions of the two parties rather than a firm commitment.

The notion of enforceability thus reinforces the "no realistic alternative to avoid the obligation" idea underlying the definition of a liability. So it is needed guidance but not 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?

Yes. If the definition of a liability is that it is a "present" obligation, then there should be guidance explaining this concept that addresses the existence of sovereign powers. The existence of the power alone is not enough – it needs to be exercised at the financial statement date in order for it to have any impact on recognition in the financial statements. The power to repudiate an obligation in the future does not negate the fact that an entity may have a present obligation at the financial statement date. This position is consistent with that taken in this response regarding the power to tax or license and the "perpetual" responsibilities of government.

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?

No.

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

Consider possible linkages with the Exposure Draft, "Key Characteristics of the Public Sector", approved at the March 2011 meeting. Explicit cross referencing with the Key Characteristics ED would strengthen the substance of the framework as one designed for the public sector. Perhaps each document issued could have a table that indicates the implications of the key characteristics for the principles set out in the document. This summary table could then be used when all of the pieces of the framework are put together to develop a matrix that outlines all of the implications of the key characteristics of the public sector.

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)?

Revenues and expenses should be determined by changes in net assets, defined as resources and obligations during the current period derived from an asset and liability led approach. This is the current approach in the existing conceptual framework in the Canadian PSA Handbook. However, PSAB has initiated a project to review the concepts underlying financial performance in that framework and may be in a position to share developments in that project with the IPSASB in the future.

(b) What arguments do you consider most important in coming to your decision on the preferred approach?

An asset and liability-led approach is grounded in the recognition of the substance of identifiable economic phenomena when they occur. This approach is most likely to provide the foundation for a theoretically sound, internally consistent set of public sector GAAP with the least inherent subjectivity. We agree with the points set

out in paragraphs 4.24-.26 in the CP. We also offer the following elaborations and additional comments.

The FASB in its 1976 conceptual framework papers stated (emphasis added):

> A conceptual framework is a "constitution", a coherent set of interrelated **objectives** and **fundamentals** that can lead to consistent standards and that prescribes the nature, function and limits of financial accounting and financial statements. The **objectives** identify the goals and purposes of accounting. The **fundamentals** are the underlying concepts of accounting, concepts that guide the selection of events to be accounted for, the measurement of those events and the means of summarizing and communicating them to interested parties. Concepts of that type are fundamental in the sense that other concepts flow from them and repeated reference to them will be necessary in establishing, interpreting and applying accounting and reporting standards.[3]

We are concerned that a revenue and expenses-led approach to financial performance may be a more ad hoc, less theoretically defensible basis for the standard setting process. It will fall to the Board to decide what goes into the categories of deferred inflows and outflows and this approach may be inherently subjective, somewhat arbitrary and the results may be inconsistent as these categories will be available for use by different Boards over time facing different issues and different controversies with its constituents. There is potential for these categories to become dumping grounds for items that a Board cannot achieve consensus for reporting in the statement of annual results.

If a revenue-expense-led approach is chosen, the IPSASB will need to establish:

- the basis for setting up a deferral (rules, criteria);
- the basis for recognizing a deferral in the statement of annual results (i.e., when, how and why to release deferrals for recognition in revenue and expenses);
- what the deferrals actually represent to users; and
- what the measures for each of the financial statements mean (i.e., individual financial statement indicators) given the possible variety of items included in the deferral categories.

Some of the arguments presented in favour of a revenue and expense-led approach to financial performance cite the importance of the matching of costs to the period services are provided and the related matching of revenues to the costs they were generated to finance, as well as the need to avoid the distortion of periodic

[3] Conceptual Framework for Financial Accounting and Reporting: Elements of Financial statements and Their Measurement, FASB, December 2, 1976

results. The achievement of inter-period/generational equity is also cited as a reason for this approach to be adopted in the public sector so that governments can manage operations to meet this equity objective for the benefit of both current and future taxpayers.

Standards set using a revenue-expense-led approach may be based on practice, experience, and general acceptance that emphasizes a preference for matching and non-distortion of annual results. These concepts are open-ended. It is difficult to set any limits on them and it is a subjective assessment to determine if proper matching and non-distortion have been achieved. Although arguments may be made that a cost recovery or inter-period equity message is provided by the statement of annual results under this approach, what is being measured by the resulting statement of financial position would be difficult to identify.

Accounting must be neutral, and if financial statements are to represent faithfully an entity's annual results, the presence of volatility must be reported to users.

Minimizing the volatile results of actual economic events should be primarily a matter for government/management policy and strategy, rather than for accounting standards. To the extent volatile economic events actually occur, the results should be reflected in the financial statements. This is crucial if the objective of providing information in financial statements for accountability purposes is to be achieved.

Standards based on an asset and liability led view should not be rejected because their implementation might cause a government/entity's management to make different decisions. One of the two primary reasons for the existence of financial information for users is to help them in making decisions. If stability or volatility of financial results is an important consideration to some users, all the more reason that the degree of stability or volatility should be faithfully reflected in the financial statements.

A February 9, 2011 speech by Hans Hoogervorst, incoming Chair of the IASB, to the European Commission on Financial Reporting and Auditing Conference stated some truths about accounting standard setting that should apply in the public sector too. He stated the following:

- "In my view, transparency is a necessary pre-condition of stability."
- "Accounting standards can contribute to stability by enhancing transparency."
- "Accounting standards can also be useful for stability purposes by avoiding artificial noise in the balance sheet and income statement."

- "Stability should be a consequence of greater transparency rather than a primary goal of accounting standard setters."
- "What accounting standard setters can also not do is to pretend that things are stable when they are not."

An asset and liability-led approach is not a "balance sheet" view that aims to diminish the value of the annual results statement. The asset and liability-led approach is an annual results viewpoint with the discipline of having the annual surplus/deficit be the result of changes in assets and liabilities. Measuring annual results as the difference in net assets provides an anchor to resolving difficult accounting questions and the anchor to sound financial reporting. By ensuring that items that do not meet the definitions of assets and liabilities are not recognized on the statement of financial position, this approach also ensures that changes in these "*whatchmacallits*" do not flow through the operating statement and distort/manage annual results.

Matching is not an objective in itself nor is it a fundamental requirement of accrual accounting. The asset and liability-led approach to financial performance does allow matching as long as it does not create items on the statement of financial position that do not meet the definition of an asset or a liability.

The argument that a revenue-expense-led approach is necessary to achieve inter- period/generational equity generally looks at this equity from a very high level and with a forward-looking emphasis. The concept of inter-period/generational equity is usually described as evaluating the extent to which future taxpayers will have to deal with the fiscal consequences of current policies

We feel that the IPSASB needs to examine the concept of inter-period or inter-generational equity and its role, if any, in general purpose financial statements (GPFS) and general purpose financial reports (GPFRs) before it is incorporated into any IPSAS or other guidance issued by the IPSASB.

GPFS: The emphasis in the Canadian framework is to ensure that the full cost of services in the accounting period is reflected in the financial statements and that the full extent of a government's revenue raising for the period is reflected in the statements. **The question of cost recovery is a policy question and the standards do not presume that this is an objective in any particular year.** The extent of taxation and other revenue raising in a particular year is a public policy decision. The financing of government activities is not an accounting decision. The financial statements report the full extent of the government's revenue raising in the year, the full cost of services provided in the year, whether the government is maintaining its net assets in a particular year and the impact of the year's activities on the government's net debt as well as

cash flow. Cost recovery is not an objective of the required financial statements in the PSA Handbook, and it is questionable whether such an assessment is possible at the high summary level of the financial statements.

At the whole of government reporting level, a cost recovery objective may be seen as requiring inter-generational or inter-period equity. Some argue that financial statements can provide information about whether inter-generational or inter-period equity has been maintained. And, balanced budget requirements and the matching of revenues and expenses are often seen as integral to maintaining such equity. If users say that they want inter-period equity, they mean it only in the simplest sense. And, they tend to mean not passing on a burden to their children – they don't consider that they might be paying for benefits received by past generations. Most discussions of inter-period or inter-generational equity are future-focused.

Inter-generational equity or even inter-period equity may be good concepts in theory but are very difficult to achieve in practice. **And again, a decision to manage government finances in order to achieve "inter-generational equity" or "inter-period equity" is a policy decision, not an accounting one. The financial statements cannot provide an assessment of whether this is achieved, nor should accounting standards make the assumption that this is government's intention.** In particular, assessments of such equity would go way beyond the operating statement of a government. Full information about the costs of services provided in a particular year might be good input into such an assessment and the extent to which a government is maintaining the net resources it needs to continue to provide services might also be good input information. But financial statements merely present a picture of what happened financially during the year (statement of operations, statement of change in net debt, statement of cash flow) and what resources/liabilities remain at the end of the year (statement of financial position). In Canada, government financial statements have a financial capital maintenance concept (in monetary terms – i.e., not adjusted for changes in purchasing power), which at most, tells users whether the government has maintained its net assets in financial terms after the activities of the accounting period have been taken into account. Good robust financial statements provide only part of the accountability picture for governments. Assessments of policy achievement and "inter-generational equity" or "inter-period equity" are beyond the scope of financial statements.

GPFRs: However, such assessments might not be beyond the scope of broader government accountability reporting. If the IPSASB believes that assessment of inter-period/generational equity is an objective of financial reporting (all financial reporting in the public sector not just governments) then it should explicitly address how and where such an assessment might be provided.

Finally, we do not believe that it is possible to define revenue and expenses without reference to change in assets. Even a liability definition generally refers to a sacrifice of economic benefits/resources.

Reed K. Storey in the FASB Special Report 181-C (January 1998) included the following quote:

> Every conceptual structure builds on a concept that has primacy. That is simply another way of saying some element must be given meaning before meaning can be attached to others. I contend that assets have that primacy. I have not been able to define income without using a term like asset, resources, source of benefits, and so on. In short, meaning can be given to assets without first defining income, but the reverse is not true. That is what I mean by conceptual primacy of assets. No one has ever been successful in giving meaning to income without first giving meaning to assets. [4]

Specific Matter for Comment 12

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

Yes. Transactions with residual/equity interests should 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?

No.

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?

No.

[4] Oscar S. Gellein, "Primacy: Assets or Income?" in *Research in Accounting Regulation,* vol. 6, edited by Gary John Previts (Greenwich, Connecticut: JAI Press, 1992), page 198

(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?

Consider possible linkages with the Exposure Draft, "Key Characteristics of the Public Sector", approved at the March 2011 meeting. Explicit cross referencing with the Key Characteristics ED would strengthen the substance of the framework as one designed for the public sector. Perhaps each document issued could have a table that indicates the implications of the key characteristics for the principles set out in the document. This summary table could then be used when all of the pieces of the framework are put together to develop a matrix that outlines all of the implications of the key characteristics of the public sector.

Specific Matter for Comment 14

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

No. Please see discussion of revenue/expense-led approach to financial performance in Matter 11 above.

(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.

If deferred inflows and outflows are to be reported on the statement of financial position, then they should be defined as separate components. It is important to keep the asset and liability definitions as pure as possible as these are concepts that transcend sector.

If deferred inflows and outflows are defined as separate elements then they can be explained separately and their contribution to financial position and results can be identified and evaluated. If they are defined as separate elements, then the standard setter can set requirements for what is included in each of these categories and when they are released for recognition in annual results.

(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?

Yes – they seem appropriate if such deferrals need to be defined as separate elements.

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?

Net assets/net liabilities are a residual amount and should not be defined as an element of financial statements.

(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?

We do not feel that the concept of ownership interests, such as those that relate to minority or noncontrolling interests in a GBE, should be incorporated in the element definition. Nor do we feel that minority or noncontrolling interests should be reported in government financial statements.

Although this is a standards level decision, we suggest that the IPSASB deal with non-controlling interests using proportionate consolidation. This approach means that minority or noncontrolling interests would not need to be incorporated in the element definition (if net assets/net liabilities were defined as an element).

If the IPSASB does not favour proportionate consolidation, then we would accept the approach set out in paragraph 5.27. That is, defining ownership interest as a separate element, which characterizes net assets/net liabilities as a residual amount that can be interpreted both as an amount available for financing future operations and ownership interests.

(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?

No.

Specific Matter for Comment 16

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

No.

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

The characteristics in paragraph 5.34 (a)-(d) seem appropriate.

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?

Recognition criteria should definitely not address existence uncertainty by basing the approach on the measurement attribute (i.e., the "situational" approach). This approach does not meet the qualitative characteristics of understandability to users unless all items are measured at fair value. This approach should not be adopted for a mixed measurement model.

Requiring a neutral judgment as to whether an element exists at the financial statement date based on an assessment of all available evidence is theoretically sound. However, we are not sure how consistent such an approach will be in application. Neutrality in judgment may be difficult to achieve and judgments may differ among individuals. We also appreciate the cost argument set out in paragraph 6.13 and the concern raised at the end of paragraph 6.12 around the possibility that items with a low probability of existence will be recognized when disclosure may be more appropriate. So this would be our second choice of the three approaches if a threshold approach is not adopted.

Ultimately, our first choice is a standardized threshold approach. We feel that it is the most pragmatic and simplest for users to understand. Consistent definitions of the thresholds and criteria for considering when those thresholds have been met in substance would amplify and assist in the application of this approach.

(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?

There should be a uniform threshold for both assets and liabilities. The threshold in the PSA Handbook, which is currently included in the asset and liability definitions and in the general recognition criteria, is "expected". FINANCIAL STATEMENT CONCEPTS, paragraph PS 1000.56 defines "expected" as:

> "Expected" is used with its usual general meaning and refers to that which can reasonably be anticipated, contemplated or believed on the basis of available evidence or logic but is neither certain nor proved. The use of the word in the recognition criteria is intended to acknowledge that economic activities occur in an environment characterized by uncertainty. It is not intended to accommodate the

> recognition of items that do not meet the definition of one of the elements of financial statements.

We suggest that separate criteria be established at the standards level to deal with contingent assets and liabilities rather than mixing the threshold for their recognition in with the threshold for assets and liabilities. This separation would be less complex and confusing for both users and preparers. The PSA Handbook does not yet address contingent assets. The threshold for contingent liabilities is "likely" and is explained in CONTINGENT LIABILITIES, Section PS 3300 as follows:

> The determination of whether a liability exists at the financial statement date depends on an assessment of the probability of a future event occurring or not occurring confirming that a liability existed at the financial statement date. The uncertainty relating to the occurrence or non-occurrence of the future event(s) can be expressed by a range of probabilities. Three areas of this range are as follows:
>
> (a) likely — the probability of the occurrence (or non-occurrence) of the future event(s) is high;
>
> (b) unlikely — the probability of the occurrence (or non-occurrence) of the future event(s) is slight; and
>
> (c) not determinable — the probability of the occurrence (or non-occurrence) of the future event(s) cannot be determined.

These Canadian thresholds ("expected" and "likely") are both higher than that used by the IPSASB in its general recognition criteria – i.e., "probable"[5]. The threshold of "probable" has been defined to mean "more likely than not", which could mean a percentage of 50.1%. This threshold encompasses assets and liabilities and contingent liabilities. The "likely" threshold used for contingent liabilities in the PSA Handbook is usually interpreted to mean greater than 70%. Thus the current International Public Sector Accounting Standards (IPSASs) would already require a public sector entity to recognize more assets, liabilities and contingent liabilities than the PSA Handbook.

We are not sure what threshold to suggest. We request that, if the IPSASB adopts a threshold approach or even a situational approach for the ED on Elements, that the document provide an analysis of the relative merits of/issues associated with, the different possible thresholds.

[5] Within the existing IPSASs, there is a possible inconsistency in interpretation of recognition thresholds in that the term "expected" is used in the element definitions and the term "probable" is used in the general recognition criteria. The term "expected" is not defined in the IPSASs. But probable is defined as "more likely than not". It is not clear whether the same meaning is attributed to both terms.

Specific Matter for Comment 18

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

We tentatively accept that the general derecognition criteria should be the obverse of the general recognition criteria as a working premise, with the proviso that derecognition requirements for specific financial statement items at the standards level may need to address some unique circumstances and may in application be different than the recognition criteria for a particular financial statement item.

By agreeing, we reluctantly overcome our ingrained and comfortable tendency towards prudence regarding the derecognition of liabilities.

Specific Matter for Comment 19

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

The recognition criteria should not be an integral part of elements definitions. Instead, they should be separate and distinction requirements.

This approach gives the building blocks of the financial statements (the elements) more clarity regarding their nature and substance. It also ensures that any expectation of the inflow or outflow of economic resources can be clearly expressed and described only in one place in the standards. Right now, there are examples in some sets of standards where it is not clear whether the degree of expectation expressed in the elements definitions is the same as that expressed in the recognition requirements, particularly when contingent assets and contingent liabilities are considered.

Appendix B
Detailed PSAB Staff Comments on the Exposure Draft

Paragraph 2.1 – last sentence

This sentence may have to be revised depending on the decision made regarding the definition of deferred inflows and outflows as elements.

Paragraph 2.18 (e)

How can holding cash create net cash inflows – is this interest on the cash held?

Paragraph 2.30

Last sentence is confusing – maybe too many negatives?

Paragraph 2.39

Include assets held in right of the Crown? The rights associated with these should be enforceable – but not by contract.

Paragraph 3.26

Example in the middle of the paragraph is confusing.

Paragraph 4.8

Revenues recognized in the period in which they were intended to finance the related costs – is this association with costs really possible at the summary financial statement level for a national or sub-national government? For example, aren't taxes raised more generally than this?

Paragraph 4.21 – 2nd sentence

Add a "should". That is, "Further, the principle that taxpayers should pay only…".

Paragraph 5.37 – last sentence

Change "would up" to "wound up".