



International
Federation
of Accountants

International Public Sector Accounting Standards Board.

Conceptual Framework:
Elements and Recognition in Financial
Statements
Agenda Item 2C

Task Based Group 2
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Dusseldorf, Germany, March 2012.

Objectives of session

Consider and provide directions on:

- The five outstanding questions in the CP (2C.1)
- Ownership issues (2C.1)
- Enforceability (2C.2)
- Deferrals (2C.2)
- CF-ED 2 (2C.3)

Residual questions

- CF-CP2 had 38 questions in 19 SMCs over 6 themes
- Board formed tentative views on 33 questions in Brasília, remaining 5 questions now
- SMC 2(b): Enforceable claim to benefits
- SMC 1(a): Definition of asset
- SMC 6(a): Definition of liability
- SMC 12(a): Relationship between residual/equity interests and revenue and expenses
- SMC 15(b): Treatment of ownership interests in definitions

Approach to session

- Residual questions-John Stanford
- Ownership issues- 2C1-Ken Warren
- Enforceability issues- 2C2-David Bean
- Deferrals-2C2- Ron Salole
- Preliminary outline ED- 2C3-Ian Carruthers

SMC 2(b): Enforceable Claim to Benefits linked to Specific Entity

- Control should be primary criterion for associating asset with a specific entity
- Majority of respondents supported view that enforceable claim to benefits or to restrict/regulate others' access linked resource to the entity
- Question whether ability to restrict/regulate access an indicator/exemplar of control or essential characteristic?
- Issue on what enforceability entails- goes beyond narrow legal sanctions but excludes moral obligations that cannot be enforced by counterparty

SMC 2(b):Enforceable Claim to Benefits linked to Specific Entity (continued)

Members Action: Do Members agree that:

- The ability to deny, restrict or otherwise regulate others' access is an indicator or exemplar of control rather than an essential characteristic that should be incorporated in the definition; and
- Guidance should not use the term 'regulate'?

SMC 1(a): Definition of Asset

- At previous meetings it was agreed that definition should cover service potential and economic benefits
- Definition proposed in 2C.1 and 2C.2 is “an asset is a resource controlled by an entity as a result of past events and from which service potential or economic benefits are expected to flow to the entity”
- Some different views within TBG so three alternatives are
 - “service potential and other economic benefits”
 - “service potential and/or economic benefits”
 - “economic benefits and other service potential”

Member Action : which wording to use?

SMC 1(a) Definition of Asset (continued)

- Most respondents supported service potential and net cash inflows in the definition
- Some had reservations about unconditional rights to receive resources. Proposal is to exclude from definition but to explain in supporting guidance that under certain conditions might give rise to assets
- Current practices for executory contracts(ECs) vary -not the place of the CF to set accounting standards for ECs

SMC 1(a):Definition of Asset (continued)

- A CF is useful in setting an approach to follow in setting standards for ECs
- Step one - has an asset or liability(as defined) been created? Possible that rights and obligations under ECs relate to future operations/activities
- Step two - if it has been created, does it meet recognition criteria?
- Step three-has an asset ,an expense (or deferral) been created?

Members Action: Do Members consider this should be reported in the BC of the ED?

SMC 1(a):Definition of Asset (continued)

- Approach to lease accounting currently follows IPSAS 13

Members Action: Do Members agree that:

- The ED should not include unconditional rights in the definition of an asset, but explain in supporting guidance that under certain conditions unconditional rights might give rise to assets; and
- The ED should take the view that executory contracts do not give rise to assets and only give rise to liabilities if the terms of the contract are onerous to one of the parties

SMC 6(a) Definition of a Liability

- For definition four types of obligation highlighted in SMC
- Only a small minority of respondents supported definition covering all four types
- At Brasilia agreed to include “past event” in definition of both assets and liabilities
- Some respondents found distinction between conditional obligation and a stand-ready obligation difficult
- Stand-ready obligation came from IASB project currently deactivated so proposal is to discuss in BC but not in CF.

Members Action: Do Members agree?

SMC 12(a) Relationship between Residual/Equity Interests and Revenue and Expenses ; SMC 15(b) Treatment of Ownership Interests in Definitions

- Because of interconnection these two questions are taken together
- Majority of respondents considered that transactions with equity interests should be excluded from revenue and expenses
- Post Brasilia further consideration given to entities set up with a view to future sale and to entities where the governing body is appointed by a tier of government, and there is a financial interest in the residual
- Difficult to identify entities in which an ownership interest exists
 - if so do they need to be defined as a separate element?
- Difficulties in interpreting comments on Consultation Paper

SMC 12(a) and SMC 15(b) (continued)

- Alternative is to assert in CF that net assets/liabilities is a residual amount ,*with sub-classifications to provide more information to users on capacity to deliver services by public sector entities*

Members Action:

Do Members agree that:

- While indicators of entities /operations in which ownership interests exist can be identified it is not possible to provide an exhaustive list of circumstances in which ownership interests exist; and
- The ED should NOT propose that ownership interests are defined as a separate element

Enforceability

- We need to agree on the characteristics of enforceability and a description; and
- Determine whether enforceability should be an essential characteristic of a liability for all obligations or only for obligations arising from non-exchange transactions-and the consequences of doing so

Enforceability (continued)

- Enforceability is primarily a legal construct
- Relates to legally binding arrangements
- Many exchange transactions are contractual in nature and therefore enforceable through the law of contract
- For some types of non-exchange transactions legal enforcement may not be straightforward
- Where government is a grantor/provider of resources in a non exchange transaction, obligation will become enforceable when eligibility requirements met by recipient- up to that point government may have ability to change/withdraw

Enforceability (continued)

- The ability to enforce may go beyond legal enforceability and could be held by regulators or professional bodies with sufficient sanction
- Enforceability does not include moral obligations that cannot be enforced by counterparty

Members Action: Do Members agree with this description of enforceability?

- If Members support a narrower legal description there is a need to examine the coercive but non-legally power of other bodies such as trade unions.

Enforceability (continued)

- The effect of making enforceability an essential characteristic of the liability definition for both exchange and non- exchange transactions needs to be examined
- For many exchange transactions an obligation becomes enforceable when entered into/takes place so liability is clear. For example numerous employee benefits may not be enforceable by the employee at the reporting date. There are other examples such as lawsuits which are not legally enforceable until the court acts or the action is settled out of court.

Enforceability (continued)

- For non-exchange transactions the main consequence of making enforceability at the reporting date an essential characteristic of a liability is that constructive obligations will NOT meet the definition of a liability
- A recent example is where a central government offered formal support to its citizens following a national disaster. However offers to individuals were not made until after the end of the reporting period. Thus if enforceability at the reporting date is a key characteristic of a liability an obligation arising in a non-exchange context such as this would not be recognized as a liability/expense of the period

Enforceability (continued)

- The TBG/staff are concerned that the enforceability only approach would lead to the omission of information which meets the QCs of faithful representation and relevance
- Enforceability as an essential characteristic of a liability for exchange transactions would preclude claims unless enforceable at the reporting date –and would exclude those to be settled later- e.g. certain employment benefits. This would give an incomplete picture of the entity's financial position.
- So TBG/staff do NOT consider enforceability should be an essential characteristic for exchange transactions

Enforceability (continued)

- TBG/staff acknowledge countervailing arguments for making enforceability an essential characteristic for non-exchange transactions. Such an approach could lead to omissions of information that meets the QCs of faithful representation and relevance.
- On the other hand, wide and varying interpretation of “no realistic alternative to avoid” in a non-exchange context without including enforceability as a key characteristic undermines understandability
- On balance TBG/staff support inclusion of enforceability as a key characteristic for non-exchange transactions

Enforceability (continued)

- On balance TBG/staff support inclusion of enforceability as a key characteristic for non-exchange transactions.
- Members need to be alert to the consequences of this view. For example excluding promised support following a national disaster would not be recognized until the accounting period in which the obligation became enforceable.
 - At Brasilia this was felt to open Pandora's Box-at least as far as it relates to the next year's budget

Enforceability (continued)

Members Action: Do Members agree that:

- Enforceability should be an essential characteristic of a liability for obligations arising from non-exchange transactions;
- Enforceability should not be an essential characteristic of a liability for obligations arising from exchange transactions?

Definition of a liability

Two options if TBG/staff recommendation is accepted

- Develop separate definitions of a liability for obligations arising from exchange and non-exchange transactions (including “enforceability” in non-exchange); or
- Develop a definition common to both and explain in supporting guidance that for non-exchange transactions “no realistic alternative to avoid” means enforceable by legal/equivalent means
- TBG/staff preference is for a single definition

Definition of Liability(continued)

- Adopting single definition option this could be “a liability is an obligation arising from a past event , and from which there is no realistic alternative to avoid, the settlement of which is expected to result in an outflow of resources from the entity”
- In supporting discussion it would be explained when and how a liability for an exchange and non-exchange obligation arises and enforceability for each

Members Action: Do Members agree with the views of TBG/staff that a single definition should be developed for liabilities covering both exchange and non-exchange obligations?

Approach to deferred outflows and deferred inflows

The purpose of this section is to consider

- Definitions for each element
- Whether a hierarchy approach is sufficiently tight for standard setting and consistent application

Deferred outflows/inflows discussed in CF-CP2

- SMC sought views on separate identification and if so views on suggested definitions and which of three options preferred
- Relatively low responses to questions. At Brasilia Members instructed further work in this area.

Approach to Deferred Outflows and Deferred Inflows (continued)

- Reiterating current tentative definitions of four traditional elements -as given in paragraph 23 ,proposed definitions of deferred outflow and deferred inflow are;
- Deferred outflow(of resources):an entity's consumption of net assets that is applicable to a future reporting period
- Deferred inflow(of resources):an entity's increase or acquisition of net assets that is applicable to a future reporting period.

Members Action: Do Members confirm these definitions of deferred outflow and deferred inflow?

Approach to deferred outflows and deferred inflows (continued)

Proposed hierarchy

- Step one-does it meet definition of an asset/liability? If yes recognize

There are now two options

- Step two-consider against definition of revenue/expenses
- Step three-consider against definition of deferred inflows/outflows

OR

- Step two- consider against definition of deferred inflows/outflows
- Step three-consider against definition of revenue/expenses
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- If item/transaction fails all steps default position is a revenue/expense of the current reporting period
- The same conclusion is reached using either route

Members Action: Do Members have a preference on the order of second/third step?

Hierarchy (continued)

Hierarchy tested against three scenarios (using revenue/expenses as second step)

Example 1- Redundancy costs

Government took decision to reduce workforce ,announced decision and made payments during accounting period.

- Step one-no asset as no control of asset after payment
- Step two-expense of reporting period
- Step three-no deferred outflow relating to future period

Hierarchy (continued)

Example 2-Central government transfers amount to local government to be spent in the following year

- Step one-No asset as no control resource after transfer
- Step two-Not an expense because amount will be used to finance the provision of goods and services in next reporting period
- Step three-Therefore conclusion is it is a deferred outflow

Hierarchy(continued)

Example 3- Public sector entity receives a grant in year one towards financing the construction of a public library requiring repayment only if funds not used for that purpose

Year one

- Step one-Inflow gives rise to a liability because grant carries condition. Therefore in year one stop at first step

Year two-construction begins

- Step one-Cost of construction shown as an asset
- Step two-The library not opened yet so no revenue costs based on provisions of IPSAS 23
- Step three-The grant is reclassified from liabilities to deferred inflow (only if the performance obligation fulfilled)

Hierarchy(continued)

Year three-library opens

- Step one-cost of construction shown as an asset
- Step two-operating costs including depreciation are expenses
- Step three-transfer of grant from deferral to revenue over expected life of the asset

Members Action: Do Members have any other examples to test the hierarchy ?

Hierarchy (continued)

Conclusion

- TBG /staff view is deferred outflows and deferred inflows should be defined as elements and the hierarchy (in the order determined by Members) should be used to guide the usage of these elements. Identification of transactions that give rise to deferrals should be determined at standards level.

Members Actions: Do Members agree with the conclusion ?
Have Members any other comments on issues raised/action to be taken?

Preliminary Outline ED-Elements and Recognition in Financial Statements

The objective of this paper is to provide Members with a preliminary outline of CF-ED2 in form of a road map to seek input from Members at this stage before drafting ED for June meeting . BC will be consolidated section at end.

Section one: Introduction

- Purpose of ED
- What are elements and why they are important
- Elements and general purpose financial reports
- Elements defined in the ED and approach to recognition
- Relationship to IASB Framework and Statistical Bases of Financial Reporting

Preliminary outline ED (continued)

Section two : Assets

- Definition
- What is a resource?
- Service potential and how it manifests itself
- What are economic benefits and how they arise?
- What control entails and indicators of control
- Need for past event
- Asset at reporting date
- Unique public sector rights/powers
- Unconditional rights to receive resources

Preliminary outline ED (continued)

Section Three :Liabilities

- Definition
- Distinguishing unconditional/conditional obligations
- Performance obligation
- Present obligations and enforceability
- Need for past event
- Sovereign power to avoid obligations
- Executory contracts

Preliminary outline ED(continued)

Section Four: Revenue ,Expenses ,Deferred Inflows and Deferred Outflows

- Definitions
- Exchange and non-exchange transactions
- Deferred Inflows and Deferred Outflows
- Hierarchy

Preliminary outline ED (continued)

Section Five: Net Assets/Net Liabilities

- Net Assets/Net Liabilities as Residual Amount
- Ownership Interests
- Further sub-classifications of net assets/net liabilities

Preliminary outline ED (continued)

Section Six: Recognition

- Recognition Criteria
- Uncertainty
- Derecognition
- Definitions and Recognition Criteria

Preliminary outline ED (continued)

Section Seven: Basis for Conclusions (consolidated)

- Introduction
- Assets
- Liabilities
- Revenue, Expenses, Deferred Inflows, Deferred Outflows
- Net Assets/Net Liabilities
- Recognition

Preliminary outline ED (continued)

- Appendix A: The IASB Conceptual Framework
- Appendix B: Statistical Bases of Reporting

Members Action: Members are asked to confirm this outline of CF-ED2 or provide alternative directions.



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