

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Ottawa, Canada

Meeting Date: December 2-5, 2013

Agenda Item 6B

For:

☐ Approval

☒ Discussion

☐ Information

Conceptual Framework: *Elements and Recognition in Financial Statements*

Objective(s) of Agenda Item

1. The objectives of the session are:

- (a) To **consider** further the options for dealing with the issue of deferred flows and **provide** directions on key issues identified by staff and the Task Based Group; and
- (b) To **consider** an Issues Paper on the first draft of certain sections of Chapter 5 and **provide** directions on those issues; and
- (c) To **review** a first draft of the final chapter and **provide** directions for further development.

Material(s) Presented

Agenda Item 6B.1	Further Issues Paper on Options for Deferred Inflows and Deferred Outflows
Agenda Item 6B.2	Issues Paper –First Draft of Chapter 5, <i>Elements and Recognition in Financial Statements</i>
Agenda Item 6B.3	Marked-up Draft of Sections of Chapter 5, <i>Elements and Recognition in Financial Statements</i>
Agenda Item 6B.4	Draft Minutes of September 2013 Meeting

CONCEPTUAL FRAMEWORK: FURTHER ISSUES PAPER ON DEFERRED INFLOWS AND DEFERRED OUTFLOWS

Objectives of Issues Paper

1. This Issues Paper considers the options for addressing the issue of deferred flows. The aim is to obtain directions so that staff and the Task Based Group can further develop the final chapter on Elements and Recognition for review at the March 2014 meeting.
2. The Issues Paper is a staff paper, which has been compiled with TBG Input. The TBG is meeting on December 1 to discuss and determine their positions on the options in the paper and will report to the IPSASB at the agenda session on December 3.

Background

3. Conceptual Framework Exposure Draft, *Elements and Recognition in Financial Statements* (CF–ED2), was issued in early November 2012 with a consultation period that expired on April 30th 2013. There were 40 responses to CF–ED2. Specific Matter for Comment 5 asked readers:
 - (a) Do you agree with the decision to define deferred inflows and deferred outflows as elements? If not, why not?
 - (b) If you agree with the decision to define deferred inflows and deferred outflows as elements, do you agree with the:
 - (i) Decision to restrict those definitions to non-exchange transactions? If not, why not?
 - (ii) Definitions of deferred inflows and deferred outflows?
4. A significant majority of respondents to SMC 5 (a) opposed the identification of deferred inflows and deferred outflows as elements. Just over a third of respondents expressing a view were classified as fully or partially supporting the development of separate elements. However, a number of these respondents acknowledged that the proposal to define deferred inflows and deferred outflows as elements was intended to respond to an important issue and agreed that there is value in providing information on deferred flows.
5. SMC 5(b) was directed at those who supported defining deferred inflows and deferred outflows as elements. Of the 23 respondents who expressed a view just over half supported the proposed definitions of deferred inflows and deferred outflows. A number of respondents challenged the conceptual validity of restricting the definition to non-exchange transactions and specifying that the flows must be linked to a specific future reporting period or periods. Respondents that opposed the identification of deferred inflows and deferred outflows as elements had different views about the treatment of deferred flows, as follows:
 - Deferred flows that do not meet the definitions of assets or liabilities should be recognized as revenues or expenses; or
 - Broaden the definitions of assets and liabilities to embrace deferred flows.

6. The Collation and Summary is available on the website as Agenda Item 2B.2 of the June 2013 meeting.
7. At the September meeting it was agreed that the IPSASB would consider revised approaches to the deferrals issue. A further draft of the “Elements and Recognition” chapter of the Conceptual Framework reflecting the IPSASB’s decisions on this and other matters would then be prepared for review at the March 2014 meeting.

The approach in CF-ED2

8. The definitions of deferred inflows and deferred outflows proposed in CF–ED2 were:
 - *A deferred inflow is an inflow of service potential or economic benefits provided to the entity for use in a specified future reporting period that results from a non-exchange transaction and increases net assets.*
 - *A deferred outflow is an outflow of service potential or economic benefits provided to another entity or party for use in a specified future reporting period that results from a non-exchange transaction and decreases net assets.*
9. As indicated above, some respondents challenged (i) why the definitions were restricted to non-exchange transactions and (ii) the requirement that the flows should be related to a specified future period. The IPSASB’s rationale for including these characteristics were as risk-avoidance measures to (i) reduce the possibility of deferred inflows and deferred outflows being used widely as smoothing devices and (ii) to ensure that deferred inflows and deferred outflows are not carried on the statement of financial position indefinitely.
10. These characteristics also represented an attempt to appease the opponents of these elements by indicating that they would be used in quite limited circumstances. This led a few respondents to suggest that the limited application did not justify the development of elements for deferred inflows and deferred outflows: the “sledgehammer to crack a walnut” argument. Criticisms of the restriction to non-exchange transactions and of the requirement that the flows be linked to specified future reporting periods were made by both respondents who strongly supported defining deferred inflows and deferred inflows and by a respondent who strongly opposed such elements. The IPSASB responded to these criticisms by directing that the TBG and Staff develop a modified approach to deferrals.

Options

11. In the view of staff there are four options for addressing deferred flows:
 - A. Defining deferred inflows and deferred outflows as elements in a manner that does not predetermine presentation of the elements
 - B. Deriving the definitions of revenues and expenses from the asset and liability definitions.
 - C. Broadening the asset and liability definitions; and
 - D. Accepting that certain economic phenomena do not meet the definition of any element.
12. Chapter 2 of the Framework identifies that the information needs of service recipients and resource providers includes information that supports assessments of an entity’s financial capacity and operational capacity. The options discussed in this Issues Paper share a view that there is value in

information on transactions and events that relate to future reporting periods. Where they differ is in how this information should be conveyed.

A. Defining deferred inflows and deferred outflows as elements in a manner that does not predetermine presentation of the elements: the alternative approach

13. This option has two strands:

(i) The elements would be disengaged from discussion or decisions on presentation in the financial statements; and (ii) the definitions of deferred inflows and deferred outflows would be revised in a principles-based way, so that they would not be restricted to non-exchange transactions and would not require the specification of a future reporting period(s).

14. CF–ED2 indicated the financial statements in which the proposed elements would be presented. Under Option A elements are defined, but the financial statements in which they are to be recognized are not specified. This approach allows more in-principle definitions of deferred inflows and deferred outflows and allows the IPSASB to further develop its thinking on the financial statements that are needed in order to meet the objectives of financial reporting. This approach responds to Alternative View (AV) A in CF–ED2. AV A argued that the treatment proposed in CF–ED2 substantially modifies the generally understood concepts of revenue and expenses as changes in net assets, and that this may have a negative impact on the users' understanding of the entity's financial performance.

15. There are two approaches to developing revised definitions of deferred inflows and deferred outflows.

16. The first approach would modify the definitions in in CF–ED2 to remove references to non-exchange transactions and specified future reporting periods. Such draft revised definitions of deferred inflows and outflows are:

- *A deferred inflow is an inflow of certain resources provided to the entity for use in a future reporting period that increases net assets.*
- *A deferred outflow is an outflow of certain resources provided to another entity or party for use in a future reporting period that decreases net assets.¹*

17. The second approach would be to revert to the 2010 Consultation Paper, *Elements and Recognition in Financial Statements*, and define deferred inflows and deferred outflows in a more general way;

- *A deferred inflow an entity's increase or acquisition of net assets that is applicable to a future reporting period.*
- *A deferred outflow entity's consumption or reduction of net assets that is applicable to a future reporting period.*

¹ These definitions reflect the current approach to the definitions of an asset and a liability at the September meeting by referring to 'resources' rather than 'service potential or economic benefits'.

18. As at the date of circulating this paper the TBG had not formed a view on which of these two sets of definitions it supports.
19. Supporters of Option A argue that these elements provide a principled mechanism that meets the objectives of financial reporting and the qualitative characteristics (QCs). According to this view this approach facilitates assessments of operational capacity.
20. Supporters also contend that, unlike some presentational approaches, defining deferred inflows and outflows does not involve recycling. Some relate this point to the difficulty that the IASB has encountered in developing principles for attributing items to profit or loss or other comprehensive income and for recycling from other comprehensive income to profit or loss. Recycling is considered to be difficult to understand and based on unclear principles². In addition Option A does not require modifications of the definitions of an asset and a liability.
21. Those who challenge Option A argue that deferred inflows and outflows are not separate economic phenomena and that separate elements are unnecessary. Paragraph AV9 of the AV B in CF–ED2 expressed this view as follows:

“from a revenue and deferred inflow perspective, when an entity demonstrates control over a resource, and the inflow is not an ownership contribution and no related obligation exists, then revenue should be recognized. Where an entity controls the underlying resource and has no related obligation, it has the ability to direct the nature and manner of use of the resulting economic benefits or service potential. As the entity has the ability to control the resource by deciding how, for what and when it can use the associated benefits, it should recognize revenue at that point. The opposite is true for expenses and deferred outflows. If an entity has an outflow of resources over which it has no further control, through, for example, the existence of rights, then an expense should be recognized.”
22. Those against Option A also express concern that the revised definitions of deferred inflows and deferred outflows leave decisions on the circumstances under which they should be used to the standards level, and provide insufficient guidance on which to base standard setting.

B. Deriving the definitions of revenues and expenses from the asset and liability definitions.

Recognition in Statement of Financial Performance

23. Supporters of Option B consider that information on inflows of resources that are provided to the entity for use in future reporting periods and outflows of resources that are provided by the entity to external bodies for use in future reporting periods can be conveyed by relying on definitions of revenues and expenses derived from the asset and liability definitions. Such presentation can be through a combination of display on the face of the financial statements and disclosure through notes.
24. Option B is consistent with AV2 in CF–ED2. AV2 argues that deferred flows should be included in the definitions of revenues and expense. The rationale is provided in paragraph 20 above. It

² See Section 8 of the IASB's Discussion Paper (DP), *A Review of the Conceptual Framework for Financial Reporting*, for a discussion of profit or loss, other comprehensive income and recycling.

considers that recognizing deferred flows as revenue or expense appropriately demonstrates the resources for which the entity is accountable.

25. According to this view the fact that deferred inflows and deferred outflows arise as a consequence of time or the passage of time is not a sound basis for delaying the recognition of revenues and expenses. Supporters of Option B reject delaying the recognition of revenues and expenses until they are used in the period stipulated by the transferor, because an entity need not use the resources in that period for revenue or expenses to be recognized in that period. This reinforces the view that control either existed or was lost in earlier reporting periods.
26. It is however acknowledged that, in certain instances, Option B may result in large surpluses or deficits being reflected in the statement of financial performance. This could be addressed through developing appropriate presentation and disclosure requirements at standards level which would provide relevant information to users of the financial statements.
27. Supporters of this view argue that it is based on principles that are transaction neutral and do not distinguish between exchange and non-exchange transactions. They object to principles that are designed and defined in a way so that a specific outcome is achieved for a specific group of transactions. This approach also allows pure definitions of revenue and expenses, an asset and a liability to be adopted.

Recycling from Residual Amount to Statement of Financial Performance

28. Some supporters of Option B take the view that deferred flows should be presented in surplus or deficit for the reporting period. Other supporters of Option B consider that deferred flows could be recognized in residual amount (net assets) and recycled to surplus/deficit as time stipulations occur. They consider that this refinement responds to the criticism in paragraph 26 that Option B does not faithfully represent an entity's operational performance. Such an approach would not be in accordance with CF-ED2 which stated that revenue and expense are elements of the statement of financial performance. However, it would be feasible if elements are not linked to specific financial statements. The Project Coordinator considers that there are attractions in this variant of Option B.
29. The variant can be illuminated by taking as an example an entity that receives a multi-year general grant with no performance obligations and no return obligations. On receipt the full amount would be treated as meeting the definition of revenue, but recognized in residual amount rather than in surplus/deficit for the year. In the year when it is intended for usage the revenue would be recycled to surplus/deficit. Obversely, where the reporting entity transfers a multi-year grant to an external body for use in future reporting periods it would recognize an expense directly in residual amount and recycle to surplus/deficit over the period for which the grant is intended to finance the operations of the external body. These items might be termed "restricted revenue" and "restricted expenses", although there is no need to go into detail in the Framework. This approach might be supplemented by explanatory disclosures giving information such as the period for which the restrictions apply.
30. Supporters of this approach see an analogy with gains and losses. The IASB's 1989 Framework defines income and expense as elements. It distinguishes two categories of income: revenue and gains. Revenue is derived from the ordinary activities of an entity while gains may include income that does not arise in the course of the ordinary activities of the entity. Similarly expense can be differentiated between expenses that arise in the ordinary activities of an entity and losses that may, or may not, arise in the course of the ordinary activities of an entity. The IASB did not define

gains and losses as separate elements on the grounds that they are no different in nature from revenues and other expenses.³ The IPSASB has used the terminology of gains and/or losses in, for example revaluations of property, plant and equipment in IPSAS 16, *Property, Plant and Equipment*, and the treatment of impairment in IPSAS 21, *Impairment of Non-Cash-Generating Assets*.

31. Those who do not support this approach consider that it introduces other comprehensive income into the reporting framework by another name and that the principles for attributing revenue and expenses to the residual amount and then recycling are vague. They also contend that it at least as arbitrary as Approaches A, C and D.

C. Broadening the definitions of an asset and a liability

32. Some respondents to the 2010 Consultation Paper, *Elements and Recognition in Financial Statements*, and CF–ED2 considered that the issue of deferred flows should be addressed by modifying the definitions of an asset and a liability rather than defining additional elements. The IPSASB has acknowledged this approach, but it has not been explored in any depth. In their recent *Commentary on Financial Reporting 1, The Conceptual Framework: Cornerstone of High Quality Financial Reporting*, Jan McCahey and Warren McGregor⁴ note that this approach was explored, but not progressed, in the United States in the early 1970s. when the following draft definitions of assets and liabilities were developed

- *Assets are economic resources and certain deferred debits that are not resources but are recognized and measured in conformity with GAAP.*
- *Liabilities are economic obligations and certain deferred credits that are not obligations but are recognized and measured in conformity with GAAP.*

33. The main advantages of such an approach are that (i) it would not require the development of separate elements to deal with deferred flows and (ii) that it would allow the definitions of revenue and expenses to be based on movements in assets and liabilities. It would also provide the standard setter with the ability to respond to particular circumstances where it concludes that deferred debits and deferred credits meet the objectives of financial reporting and the QCs., As with Options A and B this may be considered either an advantage, because it provides the ability to address issues at standards level, or a disadvantage because it allows the standard setter to decide what is an appropriate deferred credit or deferred debit on an ad hoc basis. As for Options A and B this risk can be partially mitigated by a transparent rationale in bases for conclusions.

34. Paragraph BC41 of the Basis for Conclusions of CF–ED2 explained the IPSASB's reasons for rejecting this approach as follows:

“broadening the definition of an asset and liability distorts the essence of these elements, because, in the case of assets, it would lead to including resources that an entity does not, in substance, control and in the case of liabilities obligations that are not present obligations. Such an approach would not be easily understandable to many users and may conflict with the QC of faithful representation.”

³ The IASB DP indicates that IASB does not propose to change this approach

⁴ Available from Staff on request.

35. Unless directed to the contrary, Staff and the TBG assume that the above rationale still reflects the IPSASB's views and that the IPSASB does not want to further develop Option C.

D. Accepting that certain economic phenomena do not meet the definition of any element

36. Option D would identify and define six elements; an asset, a liability, revenue, expenses, ownership contributions, and ownership distributions. Assets, liabilities, ownership contributions, and ownership distributions would be defined as in CF-ED2, while revenues and expenses would be defined to reflect increases and decreases in net assets. Option D would not define deferred inflows and deferred outflows as elements. Option D acknowledges that there are transactions and events that give rise to economic phenomena that do not meet the definition of any of the elements. Such economic phenomena may need to be recognized in financial statements in order to meet the objectives of financial reporting.
37. Supporters of Option D argue that it is transparent to acknowledge the current reality that there are economic phenomena that do not meet the definition of any of the elements and therefore that the elements will not encapsulate all transactions and events. For example, where an installment of taxation is received by an entity that is specifically related to the financing of an entity's operations in one or more future reporting periods, but with no performance obligation and return obligation, some argue that it is appropriate to present such a transaction as a receipt in advance rather than revenue or a liability. Supporters of this approach argue that such an approach is transparent and avoids "shoehorning" transactions into existing elements. It also avoids defining elements for deferred inflows and deferred outflow and gives the standard setter flexibility to respond to certain circumstances. Proponents of Option B would of course argue that an inflow of taxation in the above example meets the definition of revenue and should be recognized as such.
38. A further advantage claimed for Option D is that it keeps the definitions of an asset and a liability "pure" by not adding deferred debits and deferred credits and enables the financial statements to present the financial performance of the period without defining additional elements.
39. It is also claimed that Option D acknowledges the position which conceptual thinking has reached rather than falsely pretending it is capable of addressing all economic phenomena; for example the intellectual and institutional knowledge of an entity and the movements in that knowledge are not currently reflected in any financial statements.
40. Consideration of IPSAS 32, *Service Concession Arrangements: Grantor*, provides a further example of how Option D might be implemented at standards level. In developing IPSAS 32, the IPSASB considered the appropriate accounting treatment when, as part of a service concession arrangement, the grantor provides a right to the operator of a service concession asset to charge users of that asset. The IPSASB concluded that the grant of such a right is a liability of the grantor. Those with reservations about this approach argue that the granting of a right to the operator in exchange for a service concession asset does not meet the definition of a liability, because it does not involve a sacrifice of resources by the grantor. They argued that the event gave rise to deferred revenue. This approach would permit such a treatment and avoid the recognition of what some consider (i) an artificial liability or (ii) a "day one gain", which does not meet the QC of relevance.

41. Those with reservations about this approach argue that it lacks transparency for the users of financial statements. For example a user is not aware when reading the financial statements that a transaction that does not meet the definition of a liability is classified as a liability. They also suggest that it is inappropriate that a Conceptual Framework defines elements and then acknowledges that these elements do not deal with all transactions and events. According to this view Option D does not provide adequate guidance for the standard setter. They also consider that it diminishes accountability by allowing the standard setter to avoid the use of defined elements on an ad hoc basis. Some with reservations about this approach also argue that it can be used as a smoothing device.

Matter(s) for Consideration

1. The IPSASB is asked to **provide** directions on which of the four options identified should be adopted in the final chapter on elements and recognition

CONCEPTUAL FRAMEWORK: ISSUES PAPER—FIRST DRAFT OF CHAPTER 5**Marked-Up First Draft (partial): Chapter 5: “*Elements and Recognition in Financial Statements*”**

(Amendments to reflect decisions made at IPSASB meetings in June and September 2013)

First Draft of certain sections of Chapter 5**Introduction**

1. Agenda Paper 6B.3 is a first draft of the proposed Chapter 5 *Elements and Recognition in Financial Statements* of the Conceptual Framework—or at least those parts of the chapter dealing with assets, liabilities, ownership contributions, ownership distributions and recognition. It has been marked-up to identify amendments agreed by the IPSASB after reviewing responses to Exposure Draft 2 (CF–ED2), *Elements and Recognition in Financial Statements* at its meetings in June and September 2013. It has also been marked up to identify a number of consequential and other amendments proposed by staff to ensure consistency in use of terminology and enhance explanation of the concepts. (Please note, the additional amendments reflect the views of staff. Because of time constraints, the additional amendments have not been reviewed by the Task Based Group (TBG)).
2. Agenda Paper 6B.3 identifies amendments to CF-ED2 by marked-up text for Members’ review. Those amendments previously reviewed and agreed at the September 2013 IPSASB meeting are also identified by marked-up text. This will enable Members to identify all changes made progressively to CF-ED2 as the IPSASB moves to finalize this Chapter over the next few meetings, and to confirm that those changes articulate with each other. Boxed text in Agenda Paper 6B.3 identifies those amendments that were agreed at the September meeting 2013. An extract of the minutes of the September 2013 meeting identifying the decisions and directions of the IPSASB at that meeting is included at Agenda Item 6B.4.
3. The broad nature of amendments additional to those agreed at the September 2013 meeting is outlined below. For the most part they are amendments staff consider necessary as a consequence of the changes agreed in September 2013. Particularly to ensure that the refinements to the definition and explanation of (a) assets and resources; and (b) liabilities and present obligations are reflected in the remainder of the text. In other cases, the amendments are directed at ensuring that terminology is used consistently throughout the document, to acknowledge that responses to CF-ED2 have been received, to conform to the style of a final Chapter of the Conceptual Framework and to pick up some minor editorials. Staff has also revisited responses to CF–ED2 dealing with these sections of the proposed Chapter to ensure that all matters identified by respondents, including editorial and drafting issues, have been considered during the IPSASBs review of responses at its meetings in June and September 2013.
4. At this (December 2013) meeting, it is intended that the IPSASB will agree its position on outstanding matters such as whether the Conceptual Framework will: (a) identify deferred inflows and outflows as elements of the financial statements; (b) specify the financial statements in which each of the elements is to be recognized; and (c) reflect that the financial statements may also

recognize the effects of transactions and events that are not elements. Decisions on these matters will impact the sections of CF–ED2, and therefore this Chapter, dealing with revenues, expenses, deferred inflows, deferred outflows and net financial position. At its September 2013 meeting, the IPSASB directed that these sections should not be further developed at this stage but will be revisited as part of, or following, its considerations at the December meeting. Comment boxes in Agenda Paper 6B.3 identify sections of the text that may need to be revisited following IPSASB decisions on the identity of the elements of financial statements.

Definition of an asset and explanation of a resource

5. At its September 2013 meeting, the IPSASB agreed amendments to the definition of an asset and the explanation of a resource to respond to concerns of respondents that there was overlap and a blurring of the difference between a resource and an asset. The revised definition of an asset agreed in September 2013 is:

“2.1 An asset is a resource, ~~with the ability to provide an inflow of service potential or economic benefits~~ that an entity presently controls, and which arises from a past event.”

6. In reviewing the definition of an asset staff formed the view that the final phrase in that definition “...and which arises from a past event” is awkward and appears to mix past and present tenses. While not involving any change of substance, staff is of the view that the definition is better expressed as follows. This form of the definition also makes it clear that it is the entity’s control of the resource that results from a past event:

“An asset is a resource, ~~with the ability to provide an inflow of service potential or economic benefits~~ that an entity presently controls as a result of ~~and which arises from~~ a past event.”

7. Amendments to the remaining paragraphs of this section of the proposed Chapter (paragraphs 2.2 to 2.8) were also agreed at the September 2013 meeting, except that the first sentence of paragraph 2.3 has also been deleted. This is because the nature of a resource is now the primary focus of paragraph 2.2. The amendment to paragraph 2.2 has made retention of the sentence in para 2.3 unnecessary and repetitious.
8. Amendments to paragraphs of the Basis for Conclusions (BC) to ensure that the characteristics of an asset and a resource referred to in the BC are consistent with the definition and description of those items in paragraph 2.1 and 2.2 have also been made. These amendments are also identified by mark-up in Agenda item 6B.3.

Matter(s) for Consideration

The IPSASB is asked to **note** the staff proposed revision to the wording of the definition of an asset and to other paragraphs of the Asset section of the proposed final Chapter 5 at Agenda Item 6B.3, and to **confirm** whether it agrees with staff views.

Definition of a liability and explanation of present obligation

9. At its September 2013 meeting, the IPSASB agreed amendments to paragraphs 3.1 and 3.2 to clarify the relationship between the definition of a liability and the explanation of a present obligation. Those amendments are identified in mark-up in the attached text. The revised definition of a liability in paragraph 3.1 is:

3.1 “A liability is a present obligation of an entity for an outflow of resources that arises from a past event ~~where there is little or no realistic alternative to avoid an outflow of service potential or economic benefits from the entity.~~”

10. The amendments to the definition of a liability at paragraph 3.1 include a refinement to the text agreed at the September meeting. Staff has added the phrase “*of an entity*” in the first line of the definition to clarify that a liability is a present obligation of an entity. This parallels the definition of an asset, which reflects that an asset is a resource that an entity presently controls. (Subject to the IPSASB’s decision on further amendments to the definition of an asset as proposed by staff at paragraph 6 above, the phrase “...*that arises from a past event*” may be restated as “...*that results from a past event*” for consistency of expression.)
11. The amendments to the definition of a liability and description of a present obligation have prompted some consequential refinements to the paragraphs of the text and the BC that explain the key features of these items. Those amendments are directed at ensuring that subsequent references to a liability and a present obligation are consistent with the characteristics of each as identified in the revised paragraphs 3.1 and 3.2. For example, to:
 - (a) Reflect that a liability is defined to encompass those present obligations that involve an outflow of resources and that arise from a past event;
 - (b) Use the term “*resources*” when referring to features of a liability rather than “*ability to provide service potential or economic benefits*”—to use the same terms as in the definition; and
 - (c) Reposition paragraph 3.13 as paragraph 3.3—to draw together those characteristics that are now specifically identified in the definition of a liability rather than in the explanation of a present obligation.

These amendments are identified in mark-up in the attached text.

Other non-binding obligations

12. Some respondents to CF-ED2 expressed concern that the term “non-legal binding requirement”, which was used in the description of a present obligation in CF-ED2, could be interpreted as referring to requirements that were not legal. At its September 2013 meeting, the IPSASB agreed to respond to this concern by replacing “non-legal binding obligations” with the term “other binding obligations”. Staff has amended the text of the proposed Chapter 5 in Agenda Item 6B.3 accordingly. In the process of making these amendments staff formed the view that the meaning of the new term “other binding obligations” may not be easily understood or accessible to readers when first used in the text. Consequently staff has included at paragraph 3.4 commentary to explain and place the term in context. Staff has also used a long form explanation of the term in some paragraphs of the BC with the intent of making the document more accessible to first time readers.
13. More generally, staff found the term “other binding obligation” awkward to use and is not convinced that, even with the extra explanation included in this draft of Chapter 5, the term works well from a user understandability perspective. In this context, staff notes that one respondent to CF-ED2 (respondent 039) suggested that the term “non-legally binding obligation” be used to avoid any suggestion of illegality. On reflection, staff is of the view that this may be a better and more user friendly term than “other binding obligation”.

Political coercion

14. At its September 2013 meeting, the IPSASB considered a draft of paragraph 3.8 that that used the phrase: “*Enforceability does not include economic coercion or political coercion...*” Some Members noted that, while they supported the intent of the paragraph, they were concerned the term political coercion may not translate with the meaning intended. The IPSASB directed staff to consider whether a different term may be used. Staff has restructured the paragraph and referred to political necessity or other circumstances that may give rise to a liability arising from a binding obligation that is not enforceable in law in an attempt to draw out the underlying intent of the IPSASB.

Little or no realistic alternative to avoid

15. CF–ED2 identified the characteristics of a present obligation as including a legal or non-legal binding requirement “...*which an entity has little or no realistic alternative to avoid...*” Paragraph 3.2 of the draft Chapter 5 at Agenda Item 6B.3 also uses this phrase in its description of a present obligation:

A present obligation is a legal or other binding requirement, which an entity has little or no realistic alternative to avoid.

16. Some respondents to CF–ED2 were concerned that the phrase “*little or no realistic alternative to avoid*” may be open to different interpretations and may imply a virtual certainty threshold for determining whether a present obligation exist. At its June 2013 meeting, the IPSASB tentatively agreed to remove the phrase “*little or no*” from the description of a present obligation. A present obligation would then be described as a legal or other binding requirement which an entity has *no realistic alternative* to avoid. However, on review of the revised wording at its September 2013 meeting, the IPSASB was concerned that it did not achieve the desired effect—rather, it may be interpreted as establishing a threshold test of virtual certainty for determining whether a present obligation exists. This was not the intent of the IPSASB and consequently the IPSASB agreed that the phrase “...*little or no realistic alternative to avoid*” was to be retained.
17. Staff have included in boxed text before paragraph BC31 for Members’ review a proposed additional paragraph intended to explain that the IPSASB considered but decided against removal of the phrase “*little or no*” from the description of a present obligation.

Matter(s) for Consideration

The IPSASB is asked to **note** the staff proposed revision to the wording of the definition of a liability and amendments to other paragraphs of the *Liabilities* sections of the text and related BC of the proposed final Chapter 5 at Agenda Item 6B.3, and to **confirm** whether it agrees with staff views.

Ownership contributions and ownership distributions

18. Ownership contributions and ownership distributions are defined at paragraphs 6.3 and 6.4 of the marked-up draft Chapter 5, at Agenda Item 6B.3 as follows:
- (a) “*Ownership contributions are inflows of resources to an entity, contributed by external parties that establish or increase an interest in the net assets of the entity.*”
 - (b) “*Ownership distributions are outflows of resources from the entity, distributed to external parties that return or reduce an interest in the net assets of the entity.*”

19. At meetings in June and September 2013, Members reviewed responses to CF–ED2 that dealt with ownership contributions and ownership distributions and, after some discussion, agreed that they should be identified as elements and defined as proposed by CF–ED2 in this Chapter of the Conceptual Framework.
20. At its September 2013 meeting, the IPSASB also noted a staff view that ownership contributions and ownership distributions should not be identified as elements of the statement of financial position. Rather, the Conceptual Framework should reflect that ownership contributions and ownership distributions are reported in other financial statements included in GPFRs. The IPSASB noted that comments of some respondents to CF–ED2 also reflected some concern with the designation of ownership contributions and ownership distributions as elements of the statement of financial position. Staff proposed amendments to paragraph 1.2 and 6.2 to give effect to that view were included in the marked-up draft of CF–ED2 considered at the September 2013 meeting. Those amendments are identified by mark-up in Agenda Item 6B.3. The IPSASB agreed it would revisit the proposed amendments following its deliberations at this (December 2013) meeting on whether the Conceptual Framework will specify the financial statements in which each of the elements is to be recognized.
21. As noted above, as part of the process of developing this first draft of the proposed Chapter of the Conceptual Framework, staff has revisited responses to CF–ED2 to ensure that all matters identified by respondents have been brought to the attention of, and been considered by, the IPSASB. In that context, staff note that a number of respondents proposed that the nature of the external parties referred to in the definitions of ownership contributions and ownership distributions be clarified. Some of those respondents (for example, respondents 08, 09, 11) proposed that the definitions of ownership contributions and ownership distributions be revised to clarify that the ownership contributions and ownership distributions flow from, or to, the external parties *in their capacity as owners*. One respondent proposed that ownership distributions should be revised to refer to: “...outflows of resources from the entity, distributed to owners”, rather than to *external parties*—because ownership distributions can only be made to owners.
22. These proposed revisions to the definition of ownership contributions and ownership distributions have not previously been specifically identified as matters for Members’ consideration. Staff is of the view that these respondents make good points and the definition of ownership distributions should be revised to read:

“Ownership distributions are outflows of resources from the entity, distributed to external parties in their capacity as owners that return or reduce an interest in the net assets of the entity.”

However, staff is not convinced that the definition of ownership contributions should be revised to specify that “Ownership contributions are inflows of resources to an entity, contributed by external parties in their capacity as owners...” This is because external parties making the initial contribution that first establishes their interest in the net assets of the entity will not yet be owners.

23. Staff has included in boxed text before paragraph 6.4 of Agenda Item 6B.3, the proposed revised definition of ownership distributions for Members’ review.

Matter(s) for Consideration

The IPSASB is asked to note the revision to the definition of ownership distributions proposed by staff
--

and **confirm** whether it agrees with that revision.

Recognition

24. At its June and September 2013 meetings the IPSASB noted concerns raised by respondents regarding the recognition criteria and approved amendments to respond to a number of those concerns. Those amendments are identified by mark-up in Agenda Item 6B.3 (see paragraphs 7.5, BC58 and BC62.)
25. Having revisited responses to CF–ED2 in the preparation of this paper, Staff feel that underpinning the concern of some respondents (or perhaps it is just a staff concern) is an uneasiness about whether the distinction between (a) determining whether the definition of an element is satisfied; and (b) applying the recognition criteria of existence uncertainty as a “distinct stage”, is made clearly enough in the text and BC. (For example, paragraph BC55 explains that the first recognition criteria is “...*existence uncertainty—whether an item meets the definition of an asset.*”)
26. The meaning of existence uncertainty as a recognition criteria is captured by the second sentence of paragraph 7.4: “*If it is determined that an element exists, uncertainty about the flows of service potential or economic benefits related to that element are taken into account in the measurement of that element.*” Staff is of the view that the term “existence uncertainty” is cryptic and may fuel this concern because it does not adequately:
- (a) Capture the sense that the primary focus of the recognition criteria is assessing and dealing with uncertainty about whether the inflow to the entity, or the outflow from the entity, of service potential or economic benefits will occur as anticipated; or
 - (b) Distinguish the recognition criteria of *existence uncertainty* from the process of determining whether an item satisfies the definition of an element.
27. Staff is of the view that an effective and simple means of overcoming this concern is to retitle this recognition criteria to focus more sharply on its intent. For example, to identify the criteria as: “*Uncertainty about the flows of service potential or economic benefits*”. Subject to the IPSASB decision on this matter, consequential amendments will be necessary to paragraphs 7.1 and 7.7 and supporting commentary in the BC to ensure consistent use of the agreed term.

Matter(s) for Consideration

The IPSASB is asked to **note** the staff proposal to rename the recognition criteria currently identified as “existence uncertainty” and **confirm** whether it agrees with that proposal.

Acknowledging IPSASB discussions of financial performance and composition of the financial statements

28. At its September 2013 meeting, the IPSASB agreed that, whatever decisions might be made at this meeting, the BC should acknowledge the IPSASB’s discussion about such matters as the notions of financial performance that may be reflected in the Conceptual Framework and whether the Conceptual Framework should specify the elements that are to be recognized in the statement of financial position and statement of financial performance.
29. Additional paragraph BC3 and additions to the text of paragraph BC37 have been included to provide a basis for developing such explanation if the CF–ED2 approach is retained in the final Chapter. These paragraphs have been included primarily as a “marker” of areas for further

development at this stage. The IPSASB's decisions at this meeting will establish the direction and nature of that development.

Matter(s) for Consideration

The IPSASB is asked to **note** the staff proposed additions to the BC as a basis for acknowledgement of IPSASB discussions of notions of financial performance and contents of the financial statements at the September 2013 meeting and **confirm** that they are to be further developed.

Next Meeting

30. It is proposed that, in accordance with the timetable in the Coordinator's report, a complete draft of the proposed final Chapter "Elements and Recognition in Financial Statements" reflecting the IPSASB's decisions to date be prepared for review at the next meeting.

CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES: ELEMENTS AND RECOGNITION IN FINANCIAL STATEMENTS

MARKED UP WORKING DRAFT #1 OF CHAPTER 5 (Following IPSASB decisions made in Toronto 2013)

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Staff Note: Page and paragraph numbers and section headings will be updated for final approval

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Staff Comment: Paragraph numbers to reflect that this is Chapter 5 of the Framework will be updated for final approval.

1. Introduction

Purpose of this ~~Chapter Exposure Draft~~

- 1.1 This ~~Chapter Exposure Draft (ED) proposes~~ definitions ~~the of~~ elements used in general purpose financial statements (financial statements) of governments and other public sector entities (public sector entities) and provides further explanation about ~~thoe~~se definitions. It also deals with recognition.

Elements and their Importance

- 1.2 Financial statements portray the financial effects of transactions and other events by grouping them into broad classes which share common economic characteristics. These broad classes are termed the elements of financial statements. Elements are the building blocks from which financial statements are constructed. These building blocks provide an initial point for recording, classifying and aggregating economic data and activity in a way that provides users with information that meets the objectives of financial reporting¹ and contributes to the qualitative characteristics (QCs) of financial reporting.² The elements in the statement of financial position are assets, liabilities, deferred inflows ~~and~~, deferred outflows, ~~ownership contributions and ownership distributions~~. The elements in the statement of financial performance are revenue and expenses. ~~Ownership contributions and ownership distributions are elements of other financial statements included in GPFRs.~~ Determining which definition an item meets will, subject to the satisfaction of recognition criteria, also determine the financial statement in which the item is displayed.
- 1.3 The elements defined in this ~~Chapter ED~~ determine which information is presented in the financial statements and the generic types of such information. They are not the individual items themselves. Sub-classifications of individual items within an element and aggregations of combinations of items are used to enhance the understandability of the financial statements. Issues of presentation are addressed in ~~Chapter 6 Phase 4~~ of the *Conceptual Framework*.

Staff comment: Paragraphs 1.2 and 1.3 may need to be refined to reflect IPSASB decisions at this meeting in respect of, for example, whether the Conceptual Framework is to: (a) identify deferred inflows and deferred outflows as elements; (b) specify the financial statements in which the elements are to be recognized; and/or (c) reflect that the financial statements may also recognize the effects of transactions and events that are not elements.

Cross reference in paragraph 1.3 to the Chapter dealing with presentation to be confirmed.

¹ The objectives of financial reporting, as stated in Phase 1 of the Framework, are to provide information about the entity useful to users for accountability and decision making purposes. *(Staff Comment: This is a staff amendment to better align with the explanation of the objectives in Chapter 2.)*

² The QCs are relevance, faithful representation, comparability, verifiability, timeliness and understandability.

Elements Defined ~~in the ED~~ and Approach to Recognition

1.4 The elements that are defined in this ~~Chapter~~^{ED} are:

- (a) Assets;
- (b) Liabilities;
- (c) Revenue;
- (d) Expenses;
- (e) Deferred inflows;
- (f) Deferred outflows;
- (g) Ownership contributions; and
- (h) Ownership distributions.

1.5 Net assets is the aggregate of an entity's assets less liabilities at the reporting date and can be represented by:

$$\text{Assets} - \text{Liabilities} = \text{Net Assets}$$

1.6 Net financial position is the aggregate of an entity's assets and deferred outflows less an entity's liabilities and deferred inflows at the reporting date and can be represented by:

$$\text{Assets} + \text{Deferred Outflows} - (\text{Liabilities} + \text{Deferred Inflows}) = \text{Net Financial Position}$$

1.7 The relationship between net assets and net financial position is represented by:

$$\text{Net Assets} + \text{Deferred Outflows} - \text{Deferred Inflows} = \text{Net Financial Position}$$

1.8 While net assets and net financial position are defined, neither are elements. Section 6 discusses net assets and net financial position in more detail.

Staff Comment: Paragraphs 1.5, 1.6, 1.7 and 1.8 to be revisited pending Board decision on identification of elements and whether the financial statements may recognize amounts that are not elements.

1.9 Recognition is a separate process after a transaction or other event has met the definition of an element. Recognition is addressed in Section 7.

~~1.10 The Appendices include boxed comparisons with the International Accounting Standards Board's (IASB) Framework and Statistical Reporting Guidelines.~~

Staff Comment: Paragraph 1.10 has been deleted for consistency with IPSASB decision that comparison with IASB and GFS will not be included in the final Framework – because IASB and GFS positions may change over time. Such comparison may be made in supporting documentation if considered appropriate by the IPSASB.

2. Assets

Definition

- 2.1 An asset is a resource, ~~with the ability to provide an inflow of service potential or economic benefits~~ that an entity presently controls, and which arises from a past event.

Staff Comment: The above construction of paragraph 2.1 was agreed at the September 2013 meeting. While not involving any change of substance, staff is of the view that the definition is better expressed as:

“An asset is a resource, ~~with the ability to provide an inflow of service potential or economic benefits~~ that an entity presently controls as a result of, and which arises from a past event.”

Amendments to paragraphs 2.2 and 2.4 below were agreed at the September 2013 meeting except that the first sentence of paragraph 2.3 below has also been deleted—because this is now the primary focus of paragraph 2.2.

A Resource

- 2.2 A resource is an item with the ability to provide ~~an inflow of~~ service potential or economic benefits. ~~That resource must be controlled by the entity (see paragraph 2.6.)~~ Physical form is not a necessary condition of ~~an asset a resource~~. The benefits can arise directly from the resource itself or from the rights to the resource. Some resources embody an entity's rights to a variety of benefits including, for example, the right to:

- (a) Use the resource to provide services³;
- (b) Use an external party's resources to provide services, for example, leases;
- (c) Convert the resource into cash through its disposal;
- (d) Benefit from the resource's appreciation in value; and
- (e) A stream of cash flows.

~~Service Potential or Economic Benefits~~

- 2.3 ~~The benefits provided by a resource are service potential or economic benefits.~~ Service potential is the capacity of an asset to be used by the entity to provide ~~goods and~~ services that contribute to achieving the entity's objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows.

- 2.4 Public sector assets that embody service potential may include recreational, heritage, community, defense and other assets which are held by governments and other public sector entities and provide ~~goods and~~ services to third parties. Such ~~goods and~~ services may be for collective or individual consumption. Many ~~goods and~~ services may be provided in areas where there is no market competition or limited market competition. The use and disposal of such assets may be restricted. As highlighted in the ~~ED, Preface to the Conceptual Framework~~ Key Characteristics of the Public Sector

³ References to “services” in this Conceptual Framework encompass “goods and services”.

~~with Potential Implications for Financial Reporting (Key Characteristics)~~,⁴ many assets that embody service potential are specialized in nature in order to meet specific objectives.

2.5 Economic benefits take the form of cash inflows or a reduction in cash outflows. Cash inflows (or reduced cash outflows) may be derived from:

- (a) An asset's use in the production and sale of ~~goods and~~ services;
- (b) The direct exchange of an asset for cash or other resources; or
- (c) Holding cash itself because of its capacity to acquire other resources.

In addition, an asset may be used to settle a liability or to make an ownership distribution.

An Entity Presently Controls

~~2.6 An entity must have control of the resource at the reporting date. Control of the resource entails:~~

- ~~(a) The ability of the entity to use the asset's benefits, in the form of service potential or economic benefits, flowing from the resource; or~~
- ~~(b) The ability of the entity to direct other parties on the nature and manner of use of the benefits embodied in the resource.~~

2.6 An entity must have control of the resource-. Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.

Staff comment: The revised paragraph 2.6 was agreed at the IPSASB meeting of September 2013. It is shown here in mark-up to allow members to identify changes from CF-ED2.

2.7 In assessing whether it controls a resource, an entity assesses whether the following indicators of control exist:

- (a) Legal ownership;
- (b) Access to or, conversely, the ability to deny or restrict access to the resource;
- (c) The means to ensure that the resources are used to achieve its objectives; and
- (d) The existence of an enforceable right to service potential or economic benefits arising from a resource.

While these indicators are not conclusive determinants of whether control exists, identification and analysis of them can inform that decision. For example, if an entity cannot deny the access of certain external parties to a resource it is questionable whether the entity has an asset.

⁴ The Preface to the Conceptual Framework was made available as a staff draft in July 2013.

Past Event

2.8 The definition of an asset requires that an asset arises from a past transaction or other event. Entities can obtain assets by purchasing them in an exchange transaction or producing them. In such cases, identification of the past transaction or other event is straightforward. Assets may also arise through non-exchange transactions, including by exercising of sovereign powers. The power to tax or to issue licenses, and to access or restrict or deny access to the benefits embodied in intangible resources like the electromagnetic spectrum, are examples of powers and rights that other non-public sector entities do not have. It is essential to determine the point or event at which such rights or powers give rise to an asset of the entity. There are a number of potential points at which such events may occur. Taking the example of a tax, the following points in the process may be identified: (a) a general ability to tax, (b) establishment of a power through a statute, (c) exercising the power to create a right, or (d) the taxable event which gives rise to an obligation of another party to pay the tax. When the power is exercised and the rights exist to receive service potential or economic benefits, an asset arises.

3. Liabilities

Definition

- 3.1 A liability is a present obligation of an entity for an outflow of resources that arises from a past event, ~~where there is little or no realistic alternative to avoid an outflow of service potential or economic benefits from the entity.~~

A Present Obligation

- 3.2 A present obligation is a legal or ~~non-legal~~other binding requirement, which an entity has little or no realistic alternative to avoid, ~~that requires an entity to deliver services or economic benefits to another party.~~

Staff comment: Amendments to paragraphs 3.1 and 3.2 were agreed at the IPSASB meeting of September 2013. The above marked up paragraph 3.1 includes a refinement to the text agreed at that meeting. Staff have inserted the phrase “*of an entity*” in the first line of paragraph 3.1 to establish that it is a present obligation *of an entity*. This parallels the definition of an asset which reflects that an asset is a resource that *an entity* presently controls.

Subject to the IPSASB’s decision on further amendments to the definition of an asset as proposed by staff (see comment box following paragraph 2.1 above), the phrase “...*that arises from a past event*” may be restated as “...*that results from a past event*”.

An Outflow of ~~Service Potential or Economic Benefits~~Resources from the Entity

- 3.3 A liability must involve an outflow of ~~resource~~service potential or economic benefits from the entity in order to settle it. An obligation that can be settled without an outflow of resources from the entity is not a liability.

Staff comment: Paragraph 3.3 was previously paragraph 3.13. It has been relocated from its former positioning to this point as a consequence of the identification of the characteristics of a present obligation and a liability. This relocation draws together as the first two subsections the characteristics specifically identified in the definition of a liability. Only the changes to the text and heading of the former paragraph 3.13 are shown in mark up. Those changes are made to align the text of this paragraph with the terminology used in the definition of a liability. A resource is defined at paragraph 2.2.

Past Event

- ~~3.3.3.4~~ 3.3.4 The complexity of public sector programs and activities means that, particularly for ~~non-legal~~ binding ~~obligations~~requirements that the entity has little or no realistic alternative to avoid but are not legally enforceable (referred to as “other binding obligations” in this Conceptual Framework), there are a number of potential points in the development, implementation and operation of a program at which a present obligation may arise. To satisfy the definition of a liability, it is therefore necessary essential to identify a past event in order to determine whether an obligation is a that a present obligation arises as a result of a past event and requires an outflow of resources from the entity. Where an arrangement has a legal form a past event may be

straightforward to identify, such as when a contract is entered into. In other cases it may be more difficult to identify the past event and identification involves analysis of when an entity has little or no realistic alternative to avoid an outflow of ~~service potential resources or economic benefits~~ from the entity.

Little or No Realistic Alternative to Avoid

Legal and ~~Non-Legal~~Other Binding Obligations

~~3.43.5~~ Binding obligations can be legal obligations or ~~non-legal other obligations~~ and can arise from both exchange and non-exchange transactions. An obligation must be to an external party in order to give rise to a liability. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Identification of the external party to which the obligation is owed is an indication of the existence of an obligation giving rise to a liability. However, it is not essential to know the identity of the external party before the time of settlement in order for a present obligation and liability to exist.

~~3.53.6~~ Many arrangements that give rise to an obligation include settlement dates. The inclusion of a settlement date may provide an indication that an inflow of resources gives rise to a liability and is not an ownership contribution (see Section 6). However, there are many agreements that do not contain settlement dates. The absence of a settlement date does not preclude an obligation giving rise to a liability.

Legal Obligations

~~3.63.7~~ A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent. There are jurisdictions where government and public sector entities cannot have legal obligations because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in this Framework. For some types of non-exchange transactions, judgment will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law there can be no doubt that an entity has no realistic alternative to avoid the obligation and that a liability exists.

~~3.73.8~~ Enforceability does not include “economic coercion,” or political necessity or other circumstances where, although the public sector entity is not under a legal obligation to settle, the economic or political consequences to the entity of refusing to do so are such that the entity may not have a realistic alternative but to settle an obligation. Economic coercion, political necessity or other circumstances may, however, lead to a liability arising from a ~~non-legal~~ binding obligation that is not enforceable in law (see paragraphs 3.1 ~~10~~–3.1 ~~32~~).

Staff comment: At the September 2013 meeting the IPSASB considered a draft of paragraph 3.8 that referred to economic or *political coercion*. Members expressed concern that *political coercion* may not translate with the meaning intended and directed staff to consider whether a different term

may be used. Staff has restructured the paragraph to retain the intent but avoid the troublesome term.

~~3.83.9~~ Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date, but will be enforceable with the passage of time without the external party having to meet further conditions—that is to say having to take any further action—prior to settlement. Claims that are unconditionally enforceable subject to the passage of time therefore are enforceable obligations in the context of the definition of a liability.

~~3.93.10~~ Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for the non-recognition of obligations that, otherwise, meet the definition of a liability in this Framework. The position should be assessed at each reporting date to consider if the legal position has changed and to determine whether a liability still exists.

~~Non-Legal~~Other Binding Obligations

~~3.103.11~~ Liabilities can also arise from ~~non-legal~~other binding obligations. ~~A non-legal~~Other binding obligations ~~s~~ differs from ~~a-legal enforceable~~ obligations in that the party to whom the obligation exists cannot take legal action to enforce settlement. ~~A non-legal~~Other binding obligations ~~s~~ that gives rise to ~~a-liability~~iesy ~~haves~~ the following attributes :

- (a) The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
- (b) As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
- (c) The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

~~3.113.12~~ ~~It is essential to determine the point at which a non-legal obligation becomes binding and gives rise to a liability.~~ In the public sector, obligations may arise at a number of points. For example, there are a number of early points in implementing a program or service, including:

- (a) Making a political promise such as an electoral pledge;
- (b) Announcement of a policy;
- (c) Introduction (and approval) of budget (which may be two distinct points); and
- (d) Budget becoming effective (in some jurisdictions the budget will not be effective until an appropriation has been effected).

~~3.123.13~~ These early stages are unlikely to give rise to obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to obligations that meet the definition of a liability. The point at which ~~a non-legal binding~~ obligation gives rise to a ~~present obligation- liability~~ critically depends on the nature of the obligation. Indicators that are likely to impact on judgments about whether the

obligation is one that other parties can validly conclude that the entity has little or no realistic alternative to avoid an outflow of ~~resource~~~~service potential or economic benefits~~ include:

- (a) The nature of the past event or events that give rise to the obligation. For example, a promise made in an election is unlikely to give rise to a present **obligation** because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it cannot avoid settling. However, an announcement made in the legislature by a majority government, particularly one with all party support, in relation to an event or circumstance that has occurred, and where the government has committed to introduce and secure passage of the necessary budgetary provision may give rise to an ~~n~~ ~~non-legal~~other binding obligation.
- (b) The ability of the entity to modify or change the obligation before it crystallizes. For example, the announcement of policy will generally not give rise to an ~~n~~ ~~non-legal~~ other binding obligation which cannot be modified before being implemented. Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of ~~resource~~~~service potential or economic benefits~~ before those events occur.
- (c) There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, there is a presumption that a present ~~non-legal~~other binding obligation exists. However the absence of a budgetary provision may not, by itself be a reason for not recognizing a liability.

~~An Outflow of Service Potential or Economic Benefits from the Entity~~

~~3.13 — A liability must involve an outflow of service potential or economic benefits from the entity in order to settle it. An obligation that can be settled without an outflow of resources is not a liability.~~

Staff comment: This section has been relocated to follow para 3.2.

4. Revenue and Expenses

Staff comment: Definition and explanation of revenue and expenses is to be revisited following IPSASB decisions at this meeting about such matters as whether deferred inflows and outflows are to be identified as elements, and whether the Conceptual Framework is to specify the financial statements in which each of the elements is to be recognized.

Definitions

4.1 Revenue is:

- (a) Inflows during the current reporting period, which increase the net assets of an entity, other than:
 - (i) Ownership contributions; and
 - (ii) Increases in deferred inflows; and
- (b) Inflows during the current reporting period that result from decreases in deferred inflows.

4.2 Expenses are:

- (a) Outflows during the current reporting period which decrease the net assets of an entity, other than:
 - (i) Ownership distributions; and
 - (ii) Increases in deferred outflows; and
- (b) Outflows during the current reporting period that result from decreases in deferred outflows.

During the Reporting Period

4.3 Revenue and expenses relate to the current reporting period. This distinguishes them from deferred inflows and deferred outflows that relate to a specified future reporting period. Inflows and outflows relating to unspecified future reporting periods are attributed to revenue and expenses of the current reporting period. A reduction in liabilities can also give rise to revenue.

Increases and Decreases in Net Assets

- 4.4 Revenue and expenses can arise from exchange and non-exchange transactions, other events such as price changes, unrealized increases and decreases in the value of assets and/or liabilities, and the consumption of assets through depreciation and erosion of service potential and economic benefits through impairments. They may arise from individual transactions or groups of transactions.
- 4.5 The definitions of revenue and expenses encompass all increases and decreases in net assets other than ownership contributions, deferred inflows, ownership distributions and deferred outflows. The definition of revenue includes inflows during the current reporting period that result from decreases in deferred inflows. The definition of expenses includes outflows during the current reporting period that result from decreases in deferred outflows.

Staff comment: At its September 2013 meeting, the IPSASB noted that, subject to its decision on the identity of the elements of financial statements at this (December 2013) meeting, the meaning of "inflows" and "outflows" in the definition of revenue and expenses and their relationship to the first sentence of paragraph 4.5 may need to be revisited/clarified.

- 4.6 Section 6 discusses ownership interests and provides definitions of ownership contributions and ownership distributions. Section 5 provides definitions of deferred inflows and deferred outflows.

Financial Performance

- 4.7 All items that meet the definition of revenues and expenses and the recognition criteria set out in Section 7 are reported on the Statement of Financial Performance. The difference between revenue and expenses is the entity's surplus or deficit for the period, which is the primary indicator of financial performance.

5. Deferred Inflows and Deferred Outflows

Staff comment: Definition and explanation of deferred inflows and deferred outflows are to be revisited following IPSASB decisions at this (December 2013) meeting.

Definitions

- 5.1 A deferred inflow is an inflow of service potential or economic benefits provided to the entity for use in a specified future reporting period that results from a non-exchange transaction and increases net assets.
- 5.2 A deferred outflow is an outflow of service potential or economic benefits provided to another entity or party for use in a specified future reporting period that results from a non-exchange transaction and decreases net assets.

Specified Future Reporting Period

- 5.3 A deferred inflow is to be used by the entity in one or more specified future reporting periods. An example of a deferred inflow is a multi-year grant transferred to the entity that does not meet the definition of a liability, but includes a stipulation⁵ by the transferor that it is to be used to finance the general activities of the entity over one or more specified future reporting periods.
- 5.4 A deferred outflow is to be used by the transferee in one or more future reporting periods. An example of a deferred outflow is a multi-year grant transferred by the entity that contains ~~no conditions, but~~ a stipulation by the transferor that it is to be used for the general activities of the recipient entity or party over one or more specified future reporting periods.
- 5.5 When the specified future reporting period occurs, the flows are no longer deferred. A decrease in a deferred inflow would be recognized as revenue. A decrease in a deferred outflow would be recognized as an expense.

Non-Exchange Transactions

- 5.6 Deferred inflows and deferred outflows arise only from non-exchange transactions. Increases or decreases in net assets related to exchange transactions are accounted for as revenue and expenses, ownership contributions or ownership distributions.

⁵ For the purposes of this Conceptual Framework, stipulations are terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity, but do not specify that service potential or economic benefits are required to be returned to the transferor if not used as specified. Consequently, a stipulation does not give rise to a liability as defined in this Conceptual Framework. (Staff comment: This definition was noted at the September 2013 meeting but will be revisited following the IPSASB's final decision on the identity of the elements.)

6. Net Assets, Net Financial Position, Ownership Contributions, and Ownership Distributions

Net Assets and Net Financial Position

- 6.1 Net assets is the difference between assets and liabilities. Net financial position is the difference between assets and liabilities after deducting deferred inflows and adding deferred outflows. Neither net assets nor net financial position are elements.
- 6.2 All items that meet the definition of assets, liabilities, deferred inflows and, deferred ~~outflows, ownership contributions, and ownership distributions, and~~ outflows and satisfy the recognition criteria set out in Section 7 are reported on the Statement of Financial Position. Net financial position can be a positive or negative residual amount. Ownership contributions and ownership distributions are reported on other financial statements included in GPFRs.

Staff comment: The amendments to paragraph 6.2 were included in the marked-up draft of CF-ED2 considered at the September 2013 meeting. The IPSASB agreed to revisit this paragraph subsequent to its decision on whether this Chapter should identify and define the elements without specifying the financial statements in which they are to be recognized.

Ownership Contributions and Ownership Distributions

Definitions

- 6.3 Ownership contributions are inflows of resources to an entity, contributed by external parties that establish or increase an interest in the net assets of the entity.
- 6.4 Ownership distributions are outflows of resources from the entity, distributed to external parties that return or reduce an interest in the net assets of the entity.

Staff comment: Staff proposes that the definition of ownership distributions in paragraph 6.4 be revised to read as follows, because ownership distributions can only be made to owners:

“Ownership distributions are outflows of resources from the entity, distributed to external parties in their capacity as owners, that return or reduce an interest in the net assets of the entity.”

- 6.5 It is important to distinguish inflows of resources from owners and outflows of resources to owners, in their role as owners, from revenue, expenses, deferred inflows and deferred outflows. In addition to the injections of resources and dividend payments that may occur, in some jurisdictions it is relatively common for assets and liabilities to be transferred between public sector entities for no consideration. Where such transfers satisfy the definitions of ownership contributions or ownership distributions they will be accounted for as such.

Staff comment: The amendment to paragraph 6.5 was agreed at the September 2013 meeting. It is shown here in mark-up to allow Members to identify changes to CF-ED2.

- 6.6 Ownership interests may arise on the creation of an entity when another entity contributes resources to provide the new entity with the capacity to commence operational activities. In the public sector, contributions to, and distributions from, entities are sometimes linked to the restructuring of government and will take the form of transfers of assets and liabilities rather than

cash transactions. Ownership interests may take different forms, which may not be evidenced by an equity instrument.

- 6.7 Ownership contributions give a right to a return or increased return to owners, and may take the form of an initial injection of resources at the creation of an entity or a subsequent injection of resources, including injections in the event of the entity being restructured. The return to owners may be either a) a return on investment; b) a return of investment; or, c) in the event of the entity being wound up or restructured, a return of any net assets.

7. Recognition

Recognition Criteria and their Relationship to Disclosure

- 7.1 Recognition is the process of incorporating in the appropriate financial statement an item that meets the definition of an element and can be measured in a way that meets the QCs. Recognition is a distinct stage in the accounting process. Therefore the definitions of the elements do not include recognition criteria. Recognition involves an assessment of existence uncertainty and measurement uncertainty. The conditions that give rise to uncertainty can change. Therefore it is important that uncertainty is assessed at each reporting date.
- 7.2 The failure to recognize items that meet the definition of an element and the recognition criteria is not rectified by the disclosure of accounting policies, notes or other explanatory detail. However disclosure can provide information on items that meet many, but not all the essential characteristics of the definition of an element. Disclosure can also provide information on items that meet the definition of an element but cannot be measured in a manner that is sufficiently representationally faithful to meet the objectives of financial reporting. Disclosure is appropriate when knowledge of the item is considered to be relevant to the evaluation of the net financial position of the entity and therefore meets the objectives of financial reporting.

Existence Uncertainty

Staff comment: Staff is of the view that the recognition criteria “*Existence Uncertainty*” should be retitled to reflect that the primary focus of this criterion is on whether the inflow or outflow of service potential or economic benefits will occur as anticipated. Subject to the IPSASB decision on this matter, consequential amendments will be necessary to ensure consistent use of the agreed term. The term proposed for this recognition criterion, and therefore this section, is:

Uncertainty about the Flows of Service Potential or Economic Benefits

- 7.3 Determining whether the definition of an element has been satisfied requires judgment. Although the occurrence of a transaction is not necessary in order for an element to exist, transactions are the most common basis for recognizing and derecognizing items as elements. For example, the acquisition of medical equipment normally provides sufficient information to justify the recognition of an asset; similarly an employee providing services in accordance with a contract of employment gives rise to a liability and an expense of the employer. In other cases, it may be more difficult to determine whether an ~~economic~~ event creates an item that meets the definition of an element, because entities operate in uncertain environments.
- 7.4 Uncertainty is addressed by assessing the available evidence in order to make a neutral judgment about whether an element exists, taking into account all available facts and circumstances at the reporting date. If it is determined that an element exists, uncertainty about the flows of service potential or economic benefits related to that element are taken into account in the measurement of that element. Preparers should review and assess all available evidence in determining whether sufficient evidence exists that an element should be recognized initially, whether that element continues to qualify for recognition (see paragraph 7.7), or whether there has been a change to an existing element.

Measurement Uncertainty

- 7.5 In order to recognize an item in the financial statements, it is necessary to attach a monetary value to the item. This entails choosing an appropriate measurement basis and determining whether the measurement of the item satisfies the QCs, including that the measurement is sufficiently relevant and faithfully representative for the item to be recognized in the financial statements. The selection of an appropriate measurement basis is considered in ~~the Chapter 6, ED, Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities:~~ *Measurement of Assets and Liabilities in Financial Statements* (CF-ED3).

Staff Comment: Cross reference to the Chapter dealing with measurement to be confirmed.
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- 7.6 There may be uncertainty associated with the measurement of many amounts presented in the financial statements. The use of estimates is an essential part of the accrual basis of accounting. A decision about the relevance and faithful representativeness of measurement involves the consideration of techniques, such as using ranges of outcomes and point estimates; and whether additional evidence is available about economic circumstances that existed at the reporting date.

Derecognition

- 7.7 Derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrant removing an item that has been previously recognized from the financial statements. In evaluating existence uncertainty the same criteria are used for derecognition as at initial recognition.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

Section 1: Introduction

BC1. ~~When the IPSASB initiated Phase 2 of the Framework project, the IPSASB decided that the initial focus should be on the financial statements.~~ Respondents to Conceptual Framework, Consultation Paper, *Elements and Recognition in Financial Statements* (CF–CP2) questioned why the IPSASB was only addressing elements for the financial statements in this phase of the Framework and suggested that IPSASB should also develop elements for economic phenomena in the “more comprehensive” areas of financial reporting outside the financial statements, as outlined in ~~Chapter~~^{Phase} 1 of the Framework. The IPSASB acknowledged the merits of these views and agrees that there is a need to develop such elements in the future. The IPSASB, however, decided that in order to put its future standard-setting activities for the financial statements on a sound and transparent footing it is important to deal firstly with the development of elements for the financial statements.

Elements

Staff Comment: Subject to IPSASB decisions at the forthcoming meeting, the relationship between the first part of the second sentence of BC2 (which notes the need to distinguish between transactions which relate to current and future reporting periods) and the second part of the sentence (which concludes it is therefore necessary to distinguish between only non-exchange transactions which relate to current and future periods) may need to be revisited/clarified by a link to the paragraphs BC 47 and BC 48.

BC2. As a result of the nature of activities undertaken in the public sector, the IPSASB formed a view that a focus on the activities of the current ~~reporting period~~^{year activities} of a public sector entity is important in providing information for the users of financial statements and thereby in achieving the objectives of financial reporting. In order to distinguish between those transactions that relate to the reporting period and those that relate to a specified future period, the IPSASB concluded that those non-exchange transactions that give rise to inflows and outflows of resources that are specified for use in a different reporting period should be shown as separate elements, described as deferred inflows and deferred outflows. The introduction of these separate elements has led to the need to distinguish between net assets which is the difference between assets and liabilities, and net financial position which is assets plus deferred outflows less liabilities and deferred inflows.

Financial Statements

Staff Comment. At its September 2013 meeting, the IPSASB agreed that, whatever its final decision on whether the Framework should identify the financial statements in which each element is to be recognized, the BC should include an acknowledgement that the IPSASB had considered whether it was necessary to specify the elements that are to be recognized in the statement of financial position and the statement of financial performance. Staff is of the view that paragraph

BC3 below provides a useful basis for developing such a paragraph, if the approach in CF-ED2 is maintained.

BC3. This Conceptual Framework identifies the elements of the Statement of Financial Position and Statement of Financial Performance. The IPSASB considered whether this Chapter of the Conceptual Framework should focus on only the definition and explanation of the elements without specifying the financial statements in which those elements are to be recognised. The IPSASB noted that such an approach would allow for the ongoing development of the financial statements that might present information about financial performance and financial position. However, the IPSASB concluded that while such an approach had merit, the Statement of Financial Position and Statement of Financial Performance were, or were perceived to be, the primary vehicles for communicating information about financial position and performance to users of GPFRs, and the Conceptual Framework should provide clear direction on the elements that were to be recognised in them.

Section 2: Assets

Staff Comment. The following amendments to this section of the BC (paragraphs BC4 to BC 21) were agreed at the September 2013 meeting, except that some minor editorial and drafting amendments have been made to, for example, ensure consistent usage of terminology and consistency of style. Amendments consequential to the revisions to paragraph 2.1 and 2.2 agreed in September 2013 have also been made—to ensure that the characteristics of an asset and a resource referred to in these paragraphs are consistent with the definition and description of those items.

A Resource

~~BC3-BC4.~~ In the public sector, ~~an assets is are~~ a resource with the ability to provide services ~~potential~~ or economic benefits. The inflow of resources to an entity contributes to the operating capacity of the entity and therefore its ability to provide services in the future. This Framework, confirms in stating in paragraph 2.2 that physical form is not a necessary condition of an asset. ~~This the IPSASB acknowledge~~^{se} that many assets, such as buildings, equipment and inventories are tangible, while others, such as current rights are intangible. Financial assets, such as bonds and derivatives are a further category of assets that do not have physical form.

~~BC4-BC5.~~ The IPSASB recognized that other rights to benefits may not be directly associated with a particular tangible, intangible or financial resource. An example is the right to require other parties to perform in a certain way, by, for example, making payments or providing ~~goods and~~ services in a manner specified by the entity. One or more public sector entities may also share in the benefits under a joint venture arrangement with another entity.

~~BC5. The IPSASB then considered whether a resource arises from the following arrangements:~~

- ~~• Unconditional rights.~~
- ~~• Executory contracts.~~

Unconditional Rights

BC6. ~~The unconditional rights of external parties~~ typically result from contracts or other binding arrangements that require provision of resources to the entity in the future. The IPSASB noted that there can be a large number of such rights and concluded that such unconditional rights promises that represent service potential or economic benefits that are controlled by the entity may give rise to assets, if the entity has paid for them or if the unconditional right has acquired an identifiable value in an open, active and orderly market. Whether such assets qualify for recognition will be dependent on whether recognition criteria have been satisfied. The identification of circumstances where unconditional rights may give rise to an asset is a standards-level issue.

Staff Comment: Revisions to BC 6 were agreed at the September 2013 meeting. At that meeting staff noted the concerns of one TBG member that these revisions may be read as allowing a wide range of rights with dubious capacity to enhance the service potential or economic benefits of the entity to be recognized as assets. To mitigate this concern, and ensure that the sentence is not read as pre-empting the role of the recognition criteria, staff propose that the second sentence use the phrase “satisfy the definition of an asset” rather than “give rise to assets”, and the paragraph acknowledge that additional guidance dealing with particular circumstances may be provided at standards level. The paragraph would then read

~~“The unconditional rights of external parties~~ typically result from contracts or other binding arrangements that require provision of resources to the entity in the future. The IPSASB noted that there can be a large number of such rights and concluded that such unconditional rights promises that represent service potential or economic benefits that are controlled by the entity may satisfy the definition of an asset if the entity has paid for them or if the unconditional right has acquired an identifiable value in an open, active and orderly market. Whether such assets qualify for recognition will be dependent on whether recognition criteria have been satisfied. Additional guidance on The identification of circumstances where unconditional rights ~~may~~ give rise to an asset may be provided at is a standards-level issue.”

Executory Contracts

BC7. Executory contracts are binding arrangements, where there is an unconditional promise to receive benefits and an equal promise to transfer resources to the counterparty in the future. Public sector entities are likely to engage in a large number of such arrangements. The IPSASB acknowledged the view that such arrangements may give rise to both assets and liabilities, as the promise to receive benefits is likely to have value and the promise to transfer benefits involves a present obligation to sacrifice resources, which the entity has no realistic alternative to avoid. The IPSASB also acknowledged the view that recognizing assets and liabilities from executory contracts would involve the inclusion of potentially very large offsetting amounts in the statement of financial position and the statement of financial performance and that this may conflict with the QC of understandability. ~~The IPSASB therefore concluded that determining whether the rights and obligations related to executory contracts should be recognized as elements is a standards-level issue. Whether assets and liabilities arise from rights and obligations in executory contracts will be determined by an assessment of whether those rights and obligations satisfy the definitions and recognition criteria identified in this Conceptual Framework. Mechanisms for presentation in~~

financial statements of any elements arising from executory contracts that best satisfies the QCs will be considered at standards level.

Service Potential and Economic Benefits

BC8. The term “service potential” has been used to identify the capacity of an asset to provide ~~goods and~~ services in accordance with an entity’s objectives. The term “economic benefits” has been used to reflect the ability of an asset to generate net cash inflows. Some argue that economic benefits includes service potential, others argue that service potential includes economic benefits, and still others consider that the terms can be used interchangeably. The IPSASB considered whether in the context of the substance of an asset, the explanation of a resource definition should include a reference to both service potential and economic benefits. The IPSASB acknowledged the view that economic benefits includes service potential and also considered the converse view that because the primary objective of public sector entities is the delivery of ~~goods and~~ services, generally in non-exchange transactions, ~~that~~ service potential should be separately identified. The IPSASB noted that many respondents to CF–CP2 and CF-ED2 supported inclusion of a specific reference to service potential on the grounds noted above.

BC9. The IPSASB therefore concluded that because the primary objective of most public sector entities is to deliver ~~goods and~~ services, but also in acknowledgment of the fact that public sector entities may carry out activities with the sole objective of generating net cash inflows, the explanation of a resource definition of an asset should include both the terms service potential and economic benefits.

An Entity Presently Controls

BC10. ~~Control entails (a) the ability of an entity to use the asset’s benefits in the form of service potential or economic benefits flowing from the resource, and (b) the ability to direct other parties on the nature and manner of use of the benefits embodied in the resource.~~

Staff Comment: Paragraph BC 10 has been deleted because it is a repeat of paragraph 2.6 as was included in CF-ED2. Paragraph 2.6 has been modified. Staff is of the view that it is unnecessary to repeat paragraph 2.6 here.

BC11. The IPSASB considered whether “control” is an essential characteristic ~~in the definition~~ of an asset or whether other indicators such as (a) legal ownership, (b) the ~~ability-right to allow~~ access ~~to and~~, ~~conversely~~, to restrict or deny the access of external parties to the resource or benefits, (c) the means to ensure that the resources are used to achieve its objectives, and (d) the existence of enforceable rights to service potential or economic benefits arising from a resource, should be identified as essential characteristics of an asset ~~that should be included in the definition~~. The IPSASB acknowledged the views of those who argue that control may be difficult to apply in some cases because it requires judgment to assess whether control exists. In addition, control can be erroneously applied to a resource in its entirety and not to the individual benefits that accrue from the resource. However, notwithstanding such difficulties, the IPSASB concluded that control is an essential characteristic of an asset because the presence of control facilitates the association of an asset with a specific entity, particularly in the public sector environment.

- BC12. Legal ownership of the underlying resource, such as a property or item of equipment, is one method of accessing the benefits provided by an asset. However, rights to benefits may exist without legal ownership of the underlying resource. For example, the rights to the benefits through the holding and use of leased property are accessed without legal ownership of the leased asset itself. Therefore, legal ownership is not an essential characteristic of ~~the definition of an asset~~. Legal ownership is, however, an indicator of control.
- BC13. The right to access a resource may give an entity the ability to determine whether to (a) directly use the resource's service potential to provide services to beneficiaries, (b) exchange the benefits for another asset, such as cash, or (c) use the asset in any of the other ways that may provide benefits. While it might be questionable whether a resource that cannot be used to meet an entity's objectives gives rise to an asset, it is possible that such a resource could be exchanged for an alternative and more appropriate resource.
- BC14. While access to a resource is crucial, there are resources to which an entity has access which do not give rise to assets, such as air. Therefore, the ability to access a resource must be supplemented by the ability to deny or restrict the access of others to that resource. For example, (a) an entity might decide whether to set an entrance fee to a museum, and (b) government may control a natural resource under its land to which it can restrict the access of others. Legally enforceable claims to specific benefits such as right of road access or to explore land for mineral deposits could represent an asset to the holder. However an entity may be able to access the benefits associated with a resource in ways other than legal rights. For example, an entity may be able to ensure continuing access to specific rights by imposing effective economic or social sanctions on other parties.
- BC15. The IPSASB took the view that the factors identified in paragraphs ~~11(b), (c) and (d) BC13 and BC14~~ are likely to be persuasive indicators of the existence of control rather than essential characteristics. For example, the inability of an entity to restrict or deny access of some external parties to a resource may ~~raise doubts about~~ question whether the resource constitutes an asset of the entity.
- BC16. The IPSASB ~~considered~~ examined whether the economic ownership approach is a viable alternative to the control approach. The economic ownership approach focuses on an entity's exposure to the underlying economic attributes that contribute to an asset's value to the entity. Some respondents to CF-CP2, in supporting the control approach, commented on the complexity of the economic ownership approach. The IPSASB concluded that the economic ownership approach is subjective and difficult to operate and therefore rejected this approach. ~~The IPSASB then considered whether an analysis of exposure to the risks and rewards of ownership is a useful indicator of control. The IPSASB decided not to include such an indicator of control, because it is not compatible with the control approach.~~

Staff comment: The following paragraph (BC17) was agreed at the September 2013 meeting. It commences with the final two sentences deleted from BC16, except that the phrase "...it is not compatible with the control approach" which was included in the last sentence of BC16 has been deleted—on the grounds it is unnecessary and may not be correct in all circumstances.

BC 17 is presented in mark-up here to allow Members to identify all changes to CF-ED2.

BC17. The IPSASB considered whether an analysis of exposure to the risks and rewards of ownership is a useful indicator of control. The IPSASB decided not to include it as an indicator of control. The control approach focuses on the power of the entity to direct how the resource is used so as to benefit from the service potential or economic benefits embodied in the resource. The risks and rewards approach focuses on an entity's exposure to the underlying economic attributes that contribute to an asset's value to the entity and the related risks. Consideration of the risks and rewards associated with particular transactions and events, and which party to any transaction or event bears the majority of those risks and rewards may be relevant and useful in identifying the nature of the asset controlled by parties to the transaction or event and in determining how to quantify and associate the economic rights and obligations with particular parties. However, it is not of itself an indicator of which party controls an asset which operates to provide services to other parties, particularly when many of those services are provided in non-exchange transactions. In these cases, identifying which party bears the majority of the "risks" and receives the majority of the "rewards" associated with a resource is not necessarily an indicator of which party has the capacity to direct how the resource is used so as to meet its service delivery objectives. In addition, given the range and nature of commercial and social risks and rewards that are associated with many resources of public sector entities, it is not clear how the various risks and rewards can be weighted and aggregated to provide a useful indicator of which party bears the majority of those risks and rewards.

Past Event

~~BC17-BC18.~~ Some argue that identification of a past transaction or other event which gives rise to the asset is an essential characteristic of an asset. Others take the view that the identification of a past ~~transaction or~~ event is of less significance and should not therefore be an essential characteristic of an asset. They consider that such a requirement places undue emphasis on identifying the past event that gave rise to an asset. Such a focus may be a distraction and lead to debates about which event is the triggering event instead of focusing on whether the rights to benefits exist at the reporting date. Those who take this view consider that the essential characteristic of an asset should be the existence of a ~~present~~-resource. Some may also accept that a past ~~transaction~~event might provide useful supporting evidence of the existence of an asset-present resource.

~~BC18-BC19.~~ Many respondents to CF-CP2 and CF-ED2 took the view that a past event should be an essential characteristic of the definition of an asset. The IPSASB agreed with these respondents. In particular, the IPSASB considered that the complex nature of many public sector programs and activities means that there are a number of points at which a ~~present~~-resource might arise and therefore identification of the appropriate past event is crucial in identifying whether an asset exists.

BC19-BC20. As highlighted in the Preface to the Conceptual Framework Key Characteristics the powers and rights of government are particularly significant ~~in-for~~ the identification and recognition of assets. Assets may be created in non-exchange transactions, and by virtue of the exercise of sovereign powers. The power to tax and issue licenses, and other powers to access or to deny or restrict access to the benefits embodied in intangible resources like the electromagnetic spectrum are examples of powers that private sector entities do not have. Given the significant powers that accrue to sovereign governments, and, in certain circumstances, other public sector entities, it is often difficult to determine when such powers give rise to a right that is a ~~present~~-resource and asset of the entity.

BC20-BC21. A government's power to establish a right to levy a tax or fee, for example, often begins a sequence of events that ultimately results in the flow of economic benefits to the government. The IPSASB considered two views of when an asset arises from the powers and rights of government. The first view is that the government has an inherent power to tax at every reporting date and, therefore, that the general ability to levy taxes or fees is an asset. Proponents of this view accept that such an asset is unlikely to be capable of faithfully representative measurement, but argue that this should not deflect from the view that government has a perpetual asset. The countervailing view is that the power to levy taxes and fees must be converted into a right by legal means and that such a right must be exercised or exercisable in order for an asset to come into existence. Many respondents to CF-CP2 and CF-ED2 supported this latter view. The IPSASB agreed with these respondents. In particular, the IPSASB considered that a government's inherent powers do not give rise to assets until these powers are exercised and the rights exist to receive service potential or economic benefits.

Section 3: Liabilities

A Present Obligation

BC21-BC22. In considering when obligations are present obligations, the IPSASB accepted that a legal obligation gives rise to a present obligation. What is a binding obligation may vary between jurisdictions but there is usually general agreement that those obligations that are recognized in law in a jurisdiction give rise to a ~~present-binding~~ obligation. In some jurisdictions, public sector entities are not permitted to enter into certain legal arrangements, but there are equivalent mechanisms. Such mechanisms are considered legally binding. The IPSASB then considered how to classify other obligations. The IPSASB noted that "constructive obligations" is a term embedded in standard setting literature globally and has been used in IPSASs. However, it has proved difficult to interpret and apply in a public sector context. Therefore, the IPSASB considered alternative terminology, for example the term "a social or moral duty or requirement." The IPSASB was concerned that the term "social" might be confused with political values and that the term "moral obligations" risks a perception that standard setters and preparers are arbiters of morality. The IPSASB therefore decided that making a distinction between legal and ~~non-legal~~other binding obligations was the most straightforward and understandable approach. Paragraph BC3~~3~~4 discusses ~~non-legal~~other binding obligations.

Staff comment: The marked up amendments to the following paragraphs (BC23, BC24, BC25, BC26 and BC28) were agreed at the September 2013 meeting except that paragraph BC 25 has been

further developed to acknowledge concerns raised by respondents to CF–ED2. (Staff has also made some minor editorial refinements to paragraph BC 28.) The amendments are retained in mark-up to allow Members to identify all changes to CF-ED2.

Conditional and Unconditional Obligations

~~BC22-BC23.~~ An unconditional obligation is one that stands on its own, independent of future events. A conditional obligation relies on the possible occurrence of a future event which may or may not be under the control of the reporting entity. The IPSASB concluded that ~~distinguishing between conditional and unconditional obligations is not useful for the purpose of defining a liability because it is possible for conditional obligations to give rise to liabilities~~ as defined in this Conceptual Framework. Determining whether a conditional obligation satisfies the definition of a liability will involve consideration of the nature of the obligation and the circumstances in which it has arisen. Given the complexity of public sector programs and activities, whether the past event (or events) which has resulted in the entity having no realistic alternative to avoid an outflow of service potential or economic benefits has occurred may not always be clear. Guidance on whether ~~The identification of circumstances where~~ conditional obligations that exist in particular arrangements or circumstances may give rise to liabilities consistent with the definitions identified in this Conceptual Framework ~~is a standards-level issue~~ is a standards-level issue.

~~BC23-BC24.~~ A variety of terms are used to describe present obligations that may arise from, or exist in conjunction with, conditional obligations in particular circumstances. Amongst these are stand ready obligations and performance obligations. The characteristics of these obligations are outlined below.

Stand-Ready Obligations

~~BC24-BC25.~~ Stand-ready obligations are obligations that require an entity to be prepared to fulfill an obligation if a specified uncertain event occurs (or fails to occur). The liability is the unconditional obligation to provide a service, which results in an outflow of economic benefits. CF–CP2 included a discussion of stand-ready obligations. Many respondents indicated that the distinction between a conditional obligation and a stand-ready obligation is ambiguous. CF-ED2 explained that the term stand ready obligation is not widely used, and does not work well, in the public sector. Consequently, whether a stand-ready obligation gave rise to a liability is a standards level issue. Some respondents did not agree with the explanation in CF–ED2, noting that the Conceptual Framework should provide guidance for use at the standards level on whether stand-ready obligations can give rise to liabilities in certain circumstances. The IPSASB remains of the view that the Conceptual Framework should not specify the circumstances in which stand-ready obligations of a public sector entity would give rise to a liability. The following paragraph explains some public sector circumstances that have led to the IPSASB's view on this matter. The paragraph also confirms that while dealing with particular arrangements may be a standards level issue, whether obligations and liabilities arise from those circumstances will depend on whether they satisfy the definition and recognition criteria in the Framework.

~~BC25-BC26.~~ The ~~term~~ IPSASB formed a view that the notion of a stand-ready obligation is used to describe ~~workable and valuable in a liability that may arise in~~ certain contractual circumstances,

such as those related to insurance, certain financial instruments such as a derivative contract in a loss position, and for warranties where the entity has an unconditional obligation to stand ready to transfer the resources if the specified future event occurs. In such circumstances, there may be an identifiable past event and an outflow of resources from the entity, although the exact identity of the party to whom settlement will be made will not generally be known. The term is not widely used. ~~However, the notion of a stand-ready obligation does not work well in a public sector non-exchange context where~~ —(c) it is very difficult to distinguish a stand-ready obligation from other conditional obligations. The IPSASB was concerned that the use of the term stand-ready obligations could give rise to assumptions about the recognition of liabilities related to the nature and extent of a public sector entity's obligation to transfer resources to another entity in particular circumstances that may occur in the future includes, for example, as a potential lender of last resort and in support of programs that provide a wide range of social benefits. ~~The existence of an obligation to transfer resources to another party in these circumstances may be dependent on ongoing satisfaction of a number of conditions of differing significance and nature that are themselves subject to change by the entity or the government.~~ The IPSASB considers that the circumstances in which liabilities arise as a consequence of the obligation of a public sector entity to transfer resources to other parties consistent with the terms of programs to, for example, provide particular social benefits, and how such liabilities should be described and accounted for, did not wish this to occur, and considered that the issue of liabilities arising from social benefits should be considered at the standards level, consistent with the principles established in this Conceptual Framework. On balance, the IPSASB decided that use of the term stand-ready obligations in the Framework would not provide a sound basis for future standard setting.

Performance Obligations

~~BC26-BC27.~~ BC27. A performance obligation is an obligation in a contract or other binding arrangement between a public sector entity and an external party to transfer a resource to that other party. Performance obligations are often explicitly stated in a contract or other agreement and may vary between jurisdictions. Not all performance obligations are explicit. For example, a statutory requirement may give rise to an implicit performance obligation on a public sector entity that is additional to the terms of an agreement or contract.

~~BC27-BC28.~~ BC28. A performance obligation also arises when an entity enters into an arrangement whereby it receives a fee and, in return, provides an external party with access to an asset of the government. The IPSASB concluded it is not necessary to identify a specific external party for a performance obligation to arise, but it is important to analyze such obligations in order to determine whether they include a requirement to sacrifice resources. Obligations that require an entity to provide access to a resource, but do not entail an outflow of resources are not performance obligations and do not give rise to liabilities. However, obligations that require an entity to forgo future resources may be liabilities. ~~The IPSASB concluded that, because p~~ Performance obligations are often normally conditional obligations, and because the issues in determining whether such obligations give rise to liabilities is dependent upon the terms of particular binding agreements and may vary between jurisdictions, it would not be appropriate to use the term "performance obligation" in the Framework.

Past Event

~~BC28-BC29.~~ The IPSASB considered whether the definition of a liability should require the existence of a past transaction or other event. Some contend that identification of a past event is not an essential characteristic of a liability and that there is consequently no need for the definition of a liability to include a reference to a past event. These commentators argue that there may be many possible past events and that establishing the key past event is likely to be arbitrary. They suggest that the existence of a past event is irrelevant in determining whether a liability~~present obligation~~ exists at the reporting date.

~~BC29-BC30.~~ The IPSASB acknowledged this view, but also noted that many respondents to CF-CP2 and CF-ED2 considered it necessary to include a specific reference to a past event. The IPSASB agreed with the view that the complexity of many public sector programs and activities and the number of potential points at which a present obligation might arise means that, although challenging, identification of the key past event that gives rise to a liability is critical in determining when public sector liabilities should be recognized.

Little or No Realistic Alternative to Avoid

Staff comment: Staff propose insertion of a new paragraph before BC 31—to explain that the IPSASB considered but decided not to remove the phrase “*little or no*” from the description of a present obligation

Proposed additional paragraph:

“Some respondents to CF-ED2 were concerned that the phrase “little or no realistic alternative to avoid” in the description of a present obligation was open to different interpretations and proposed removal of the words “little or” from this phrase as a means to reduce the potential for misinterpretation. The IPSASB considered this proposal but was concerned that the removal of these words may be interpreted as establishing a threshold test of virtual certainty in determining whether a present obligation exists. This was not the intent of the IPSASB. Consequently, the IPSASB confirmed that a present obligation is a legal or other binding requirement that an entity has little or no realistic alternative to avoid.”

~~BC30-BC31.~~ Interpreting the term “little or no realistic alternative to avoid” in the context of a present obligation~~liability~~ is a crucial issue in public sector financial reporting. In particular, the IPSASB considered the issue of whether liabilities can arise from obligations that are not enforceable by legal or equivalent means. The IPSASB acknowledged that determining when a present obligation arises in a public sector context is complex and, in some cases, could be considered arbitrary. In the context of programs to deliver social benefits there are a number of stages at which a present obligation can arise and there can be significant differences between jurisdictions, even where programs are similar, and, over time, within the same jurisdiction. For example, different age cohorts are likely to have different expectations about the likelihood of receiving benefits under a social assistance program. Such variation does not promote consistency and can mean that information reported on liabilities does not meet the QC of understandability. This may lead to a view ~~suggests~~ that an essential characteristic of a liability should be that it is enforceable at the reporting date by legal or equivalent means.

~~BC31-BC32.~~ A converse view is that where a government has a record of honoring obligations, failing to recognize them leads to an understatement of that government's liabilities. For example, if a government has a consistent record of meeting publicly-announced obligations to provide financial support to the victims of natural disasters, a failure to treat such obligations as liabilities is not in accordance with the objectives of financial reporting and, in particular, does not meet the QCs of faithful representation and relevance.

~~BC32-BC33.~~ On balance, the IPSASB agreed with those who argue that, in the public sector, liabilities can arise from ~~non-legal~~ binding obligations that the entity has little or no realistic alternative to avoid even if they are not enforceable in law. The IPSASB decided to use the term "other binding obligations" for such obligations in the Conceptual Framework. However, the IPSASB acknowledged the views of those who are skeptical that liabilities can arise from other than legally enforceable obligations. Consequently, this Chapter of the Conceptual Framework identifies the attributes that ~~The IPSASB considers that an non-legal~~ other binding obligation which gives rise to a liability will possess the following attributes:

- ~~(a) The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;~~
- ~~(b) As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and~~
- ~~(c) The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.~~

~~BC33-BC34.~~ The wide variation in the nature of public sector programs and operations and the different political and economic circumstances of jurisdictions globally means that categorical assertions of the circumstances under which ~~non-legal~~ obligations not enforceable in law become binding and give rise to present obligations are inappropriate. However, the IPSASB concluded that present obligations are extremely unlikely to arise from election promises. This is because electoral pledges will very rarely (a) create a valid expectation on the part of external parties that the entity will honor the pledge, and (b) create an obligation which the entity has no realistic alternative but to settle. Therefore the Framework includes a presumption that liabilities do not arise from electoral pledges or promises. However, it is accepted that in practice a government with a large majority will be better placed to enact intended legislation than a minority government and that there may be infrequent circumstances where a government announcement in circumstances like those in BC ~~320~~, might give rise to a liability. In assessing whether an ~~n non-legal~~ other obligation gives rise to a liability the availability of funding to settle the obligation may be a persuasive indicator.

Sovereign Power to Avoid Obligations

~~BC34-BC35.~~ The sovereign power to make, amend and repeal legal provisions is a key characteristic of governments. Sovereign power potentially allows governments to repudiate obligations, arising from both exchange and non-exchange transactions. Although in a global environment, such a power may be constrained by practical considerations, there are a large number of examples of governments defaulting on financial obligations over the last century. The IPSASB considered the

impact of sovereign power on the definition of a liability. The IPSASB concluded that failing to recognize obligations that otherwise meet the definition of a liability on the grounds that sovereign power enables a government to walk away from such obligations would be contrary to the objectives of financial reporting and, in particular, may conflict with the QCs of relevance and faithful representation. Many respondents to CF-CP2 and CF-ED2 supported this position. The IPSASB therefore concluded that the determination of whether a liability exists should be by reference to the legal position at the reporting date.

Staff comment:

Paragraph BC 36 was approved in September 2013 as an acknowledgement of the role of commitments in the public sector. It is presented in mark-up to allow Members to identify changes from CF-ED2.

Commitments

BC36. Commitment accounting procedures are a central component of budgetary control for public sector entities in many jurisdictions. They are intended to assure that budgetary funds are available to meet the government's or other public sector entity's responsibility for a possible future liability, including intended or outstanding purchase orders and contracts or where the conditions for future transfers of funds have not yet been satisfied. Commitments which satisfy the definition of a liability and the recognition criteria will be recognized in financial statements, in other cases information about them may be communicated in notes to the financial statements or other reports included in GPFRs.

Section 4: Revenue and Expenses

Nature of Revenue and Expenses

~~BC35-BC37.~~ CF-CP2 explained that one approach to defining revenue and expenses is to take the view that they can be derived from changes in assets and liabilities. The IPSASB acknowledged and noted that this approach has been adopted by many standard-setters globally. CF-CP2 also noted that another view is that revenue and expenses are flows that relate to the current period, and outlined the measures of financial performance that would be presented in financial statements under each approach. There was considerable support for both positions by respondents to CF-CP2. In developing this Chapter of the Conceptual Framework, the IPSASB noted that there was a case that both these measures of financial performance may be relevant and useful to users, and one or other of the measures should not be excluded from presentation in the financial statements as a result of decisions the IPSASB may make about the identity and nature of the elements to be presented in the statement of financial performance. Rather, the Conceptual Framework should identify the characteristics of the elements and, as appropriate, IPSASs could provide guidance on how these elements may be assembled to present information about the different measures of financial performance. The composition and type of the financial statements that would be used to present the elements would then be specified at standards level as appropriate, and may evolve over time and be influenced and enhanced by jurisdictional considerations.

Staff comment. The IPSASB agreed that this section will be revisited following its decision on whether deferred inflows and deferred outflows are to be identified as elements. However, at its September 2013 meeting, the IPSASB also agreed that, whatever its final decision on the elements, the BC is to note that the IPSASB had considered whether the Conceptual Framework should be constructed so as not to preclude one or other of the measures of financial performance identified in the Consultation Paper (CF-CP2) from being presented in the statement of financial performance and to allow the financial statements to evolve over time.

The amendments to paragraph BC 37 are intended to respond to that direction. However, the amendments will need to be revisited and refined as the IPSASB makes its final decision on matters addressed herein.

~~BC36-BC38.~~ The IPSASB formed a view that a focus on the activities ~~of the current year-reporting period~~ activities of a public sector entity is important in providing information for the users of financial statements and thereby in achieving the objectives of financial reporting. Including flows as revenue and expenses in one reporting period where there are ~~stipulation~~ timing restrictions specifying their use in future periods would be misleading. This led to the conclusion that, in precisely defined circumstances, certain flows do not meet the definition of revenue and expenses, but rather are deferred inflows and deferred outflows. The rationale for defining deferred inflows and deferred outflows as elements is further considered in BC4~~30~~~~63~~. The IPSASB took the view that the definitions of revenue and expenses should reflect the inflows of resources used to finance such ~~goods and~~ services and the outflows of resources related to providing ~~goods and~~ services in the reporting period.

Staff comment. The reference to current reporting period and stipulations (rather than *conditions* or *restrictions*) were tentatively agreed at the September 2013 IPSASB meeting. However, subject to IPSASB decisions at this meeting regarding the identification of deferred inflows and deferred outflows as elements, paragraph 38 may need to be revisited and updated more broadly.

~~BC37-BC39.~~ The IPSASB considered whether the definition of revenue should be the “net” or “gross” increase in “net” assets. The IPSASB recognized that a “gross” approach would create problems in areas such as the disposal of property, plant, and equipment where such a definition would require the full disposal proceeds to be recognized as revenue, rather than the difference between the disposal proceeds and the carrying amount. Therefore the IPSASB considered that the gross approach is not ideal. The IPSASB acknowledged that standards may require the gross presentation of the relevant flows on the face of the financial statements in certain circumstances, for example, the sale of inventory.

~~BC38-BC40.~~ Some standard setters have structured their definitions of elements so that, for example, inflows and outflows arising from transactions and events relating to activities in the ordinary course of operations are distinguished from inflows and outflows that relate to activities outside the ordinary course of operations. An example of this approach is the definition of revenue, expenses, gains and losses as separate elements, where revenue and expenses relate to entity’s “ongoing

major or central operations”, and gains and losses relate to all other transactions, events and circumstances giving rise to increases or decreases in net assets.⁶

~~BC39-BC41.~~ The IPSASB acknowledged that distinguishing transactions and events related to the ordinary course of operations from transactions and events outside the ordinary course of operations can provide useful information for users of the financial statements. It may be useful therefore to adopt the terms gains and losses to reflect inflows and outflows from transactions and events outside the ordinary course of operations. However, the IPSASB took the view that, conceptually, gains and losses do not differ from other forms of revenue and expenses, because they both involve net increases or decreases of assets and/or liabilities. The IPSASB also noted that many respondents to CF-CP2 and CF-ED2 shared this view. Therefore the IPSASB decided not to define gains and losses as separate elements.

~~BC40-BC42.~~ As discussed in more detail in BC~~5148~~-BC~~530~~, the IPSASB considered whether, and, if so, under what circumstances, ownership interests exist in the public sector. In the context of revenue and expenses the IPSASB considered whether transactions related to ownership interests should be excluded from the definitions of revenue and expenses. Because transactions with owners, in their role as owners, are different in substance to other inflows and outflows of resources the IPSASB concluded that it is necessary to distinguish flows relating to owners from revenue and expenses. Therefore ownership contributions and ownership distributions are defined as elements.

Section 5: Deferred Inflows and Deferred Outflows

Nature of Deferred Inflows and Deferred Outflows

~~BC41-BC43.~~ ~~As identified in Key Characteristics aA~~ highly important characteristic of the public sector is the prevalence of non-exchange transactions. Such transactions include (a) involuntary transfers of resources, notably taxation, and grants, which may be received prior to the period in which they are intended to finance the provision of ~~goods and~~ services, and (b) transfers of resources with timing ~~stipulations restrictions~~ or expectations and no performance or return obligations. Information on the extent to which the cost of providing services has been financed by revenue of the same reporting period is highly useful for accountability and decision-making purposes. It is therefore important to be able to show separately flows that relate to specified future reporting periods, instead of including them in the Statement of Financial Performance of the current reporting period. There are a number of ways in which user needs can be satisfied. The IPSASB identified and considered:

- Broadening the asset and liability definitions to include deferred inflows and deferred outflows⁷;

⁶ See for example Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 6: Elements of Financial Statements.

⁷ This approach could be supplemented by sub-classifying net assets/net liabilities to include information about deferred inflows and deferred outflows.

- A presentational approach along the lines of “other comprehensive income” (OCI) in International Financial Reporting Standards (IFRSs) would have to be developed and adopted;
- Dealing with deferred inflows and deferred outflows through note disclosure or other forms of communication; and
- Defining deferred inflows and deferred outflows as separate elements.

~~BC42-BC44.~~ The IPSASB considered that broadening the definition of an asset and liability distorts the essence of these elements, because, in the case of assets, it would lead to including resources that an entity does not, in substance, control and in the case of liabilities obligations that are not present obligations. Such an approach would not be easily understandable to many users and may conflict with the QC of faithful representation. A sub-classification of net assets would only partially compensate for this, because it relegates the results of potentially major flows to a sub-category of the residual amount.

~~BC43-BC45.~~ The use of a presentational approach would have to be considered on an issue-by-issue basis at the standards level, which might lead to inconsistency. The IPSASB considered that dealing with deferred inflows and deferred outflows through note disclosure is contrary to the principle that disclosure is not a substitute for recognition, which is stated in Section 7.

~~BC44-BC46.~~ The IPSASB therefore concluded that the most transparent approach is to define deferred inflows and deferred outflows as separate elements. In coming to this view the IPSASB considered it likely that, if separate elements are not defined, the treatment of flows that are considered applicable to future reporting periods is likely to be addressed on an issue-by-issue basis at the standards level, using ambiguous and potentially conflicting principles.

Staff Comment: The following additional paragraph is proposed to acknowledge that the IPSASB has considered identification of deferred inflows and deferred outflows as elements of the statement of financial performance. This paragraph was noted by the IPSASB at its meeting in September 2013. It was agreed that, as appropriate, it would be revisited as the IPSASB finalises its views on the treatment of deferrals.

Proposed additional paragraph:

“The IPSASB also considered whether deferred inflows and deferred outflows should be identified as elements of the statement of financial performance to overcome concerns identified in BC 44 and BC 45. The statement of financial performance could then report a surplus (deficit) before deferred items (Revenue – Expenses) and after deferred items (Revenues – Expenses + (deferred outflows – deferred inflows)). However, this approach was rejected because of concerns that it would require recycling of deferred inflows and outflows to revenues and expenses of the time stipulated period of their use, and this would unnecessarily complicate and undermine the understandability of the financial statements.”

Specified Future Period and Non-exchange Transactions as an Essential Characteristic of Deferred Inflows and Deferred Outflows

BC45-BC47. The IPSASB acknowledged reservations about defining deferred inflows and deferred outflows (for example, that such elements might be used inappropriately or that usage of such elements would be determined at the standards level). It has been suggested that broad definitions of deferred outflows could be used to spread certain costs inappropriately (for example, redundancy costs) over several reporting periods, based on an assertion that these costs will produce savings and therefore a reduction of outflows of resources over a number of subsequent reporting periods.

BC46-BC48. Such concerns led the IPSASB to narrow the application of deferred inflows and outflows to public sector circumstances. Deferred inflows and deferred outflows are therefore restricted to certain non-exchange transactions, because they do not meet the definition of revenue or expenses as they relate to a specified future reporting period, and they do not give rise to assets, liabilities, ownership contributions or ownership distributions. Based on this approach, a property tax levied and collected in one period that is required by law to be spent in a specified future period would be reported as a deferred inflow. Multi-year grants with no substantive performance obligations and no return obligations would only be presented as deferred inflows or deferred outflows if the period over which those resources can be used is documented and recorded and the resources are actually used in those periods, as specified in the grant agreement. Exchange transactions give rise to revenue, expenses, assets, liabilities, ownership contributions or ownership distributions in the period of the exchange and the IPSASB considered that it is therefore not appropriate to include these transactions in the definitions of deferred inflows or deferred outflows.

BC47-BC49. Recognizing deferred inflows and deferred outflows is not the same as the matching concept used in earlier private sector frameworks. The IPSASB agreed that when the time ~~stipulation~~~~restriction~~ associated with a deferred inflow or deferred outflow comes to an end, the deferred inflow or outflow must be reassessed. A reduction in a deferred inflow would be recognized as revenue at that point and a reduction in a deferred outflow would be recognized as an expense at that point. The IPSASB noted that limiting the use of these elements to clearly specified circumstances is consistent with the objective of providing information to users about the impact of external ~~stipulations~~~~restrictions~~ on an entity's ability to use resources in a period.

Section 6: Net Assets, Net Financial Position, Ownership Contributions, and Ownership Distributions

Staff comment:

The amendments to paragraph BC 50 below were noted by the IPSASB at its meeting in September 2013. Members agreed that these paragraphs will be revisited following Board decisions on the identification of deferred inflows and deferred outflows as elements.

BC48-BC50. The IPSASB's decision to propose the elements of deferred inflows and deferred outflows means that both net assets and net financial position have to be distinguished. Net assets is the difference between assets and liabilities before taking into account deferred inflows and deferred outflows. Net financial position is the aggregate of an entity's assets and deferred outflows

less an entity's liabilities and deferred inflows at the reporting date. A positive net financial position represents the net resources available for providing goods or services in future periods. A negative net financial position indicates that insufficient revenues have been generated at the reporting date to meet the expenses of the entity in the provision of services and should raise the question about how this shortfall will be addressed in future periods, whether from increased revenue, a reduction in expenses, or a combination of both. However, any interpretation of a negative net financial position would need to be made after consideration of such matters as whether net assets are positive and in the context of the longer run performance of the reporting entity.

~~BC49-BC51.~~ The IPSASB considered whether net financial position is a residual amount, a residual interest or an ownership interest. The IPSASB acknowledged the view that the interest of resource providers and service recipients in the long-term efficiency of the entity, its capacity to deliver ~~goods~~ ~~and~~ services in the future and in the resources that may be available for redirection, restructuring or alternative disposition is similar to an ownership interest. The IPSASB also accepted that the terms residual interest and ownership interest have been used in some jurisdictions to characterize third parties' interests in net assets. The term residual interest indicates that service recipients and resource providers have an interest in the capability of the entity to finance itself and to resource future operations. The term ownership interest is analogous to the ownership interest in a private sector entity and, for some, indicates that the citizens own the resources of the public sector entity and that government is responsible to the citizens for the use of those resources. Some argue that this emphasizes the democratic accountability of governments.

~~BC50-BC52.~~ The IPSASB took the view that the term residual interest may suggest that service recipients and resource providers have a financial interest in the public sector entity. Similarly the term ownership interest suggests that citizens are entitled to distributions from the public sector entity and to distributions of net assets in the event of the entity being wound up. The IPSASB therefore concluded that the terms residual interest and ownership interest can be misunderstood or misinterpreted, and that net financial position is a residual amount that should not be defined. Treating net financial position in such a way is more straightforward and understandable.

Staff comment:

The amendments to paragraph BC53 below were agreed by the IPSASB at its meeting in September 2013. The paragraph is presented in mark-up to allow Members to identify changes from CF-ED2.

~~BC51-BC53.~~ However, the IPSASB acknowledged that part of net financial position can in certain circumstances be an ownership interest. Such instances may be evidenced by the entity having a formal equity structure, but there may be instances where an entity is established without a formal equity structure, with a view to sale for operation as a commercial enterprise or by a private sector not-for-profit entity. An ownership interest can also arise from the restructuring of government or public sector entities, such as when a new government department is created. The IPSASB therefore considered whether "ownership interests" should be defined as an element. The IPSASB acknowledged the view that identifying the resources (or claims on future resources) attributable to owners provides information useful for accountability and decision-making purposes. The IPSASB concluded that such interests can be identified through the sub-classification of net financial position. However, the IPSASB also concluded that it is important to distinguish inflows of

resources from owners and outflows of resources to owners, in their role as owners, from revenue, expenses, deferred inflows and deferred outflows. Therefore ownership contributions and ownership distributions are defined as elements. Detailed guidance to support the assessment of whether certain inflows and outflows of resources satisfy the definitions of ownership contributions and ownership distributions can be developed at standards level as appropriate.

Section 7: Recognition

Recognition and its Relationship to Disclosure

~~BC52-BC54.~~ The IPSASB considered whether recognition criteria should be integrated in definitions. The IPSASB acknowledged the view that the inclusion of recognition criteria in definitions enables preparers to consider all the factors that must be taken into account in evaluating whether an item of information is recognized in the financial statements. However, the IPSASB took the view that recognition is a distinct ~~stage~~^{phase} in the financial reporting process. The IPSASB also noted that few respondents to CF-CP2 and CF-ED2 supported the integration of recognition criteria in element definitions. After considering this feedback, the IPSASB concluded that element definitions should not include recognition criteria.

Assessing Recognition

Staff comment: Subject to Members' reaction to staff proposals, the term *existence uncertainty* may be revised to *uncertainty about the flows of service potential or economic benefits*. Staff is of the view that the second sentence of paragraph BC55 below tends to reinforce uncertainty about whether application of existence uncertainty and satisfaction of the definition of an element are indeed separate or distinct stages.

~~BC53-BC55.~~ In determining whether an element should be recognized there are two types of uncertainty that need to be considered. The first is existence uncertainty—whether an item meets the definition of an element? The second is to consider measurement uncertainty—whether the element can be measured in a representationally faithful manner? The second aspect is only considered if it is determined that the definition of an element has been met.

Existence Uncertainty

~~BC54-BC56.~~ The IPSASB also considered whether, in dealing with existence uncertainty, (a) standardized threshold criteria should be adopted, or (b) whether all available evidence should be used to make neutral judgements about an element's existence.

~~BC55-BC57.~~ Standardized evidence thresholds filter items that have a low probability of resulting in an inflow or outflow of service potential or economic benefits. Such items may have high monetary values and therefore lead to the recognition of elements with significant amounts, even though the probability of existence may be low. Some consider that it would be more appropriate to disclose such items rather than recognize them. Threshold criteria are also justified on cost grounds, because only after a preparer has formed an initial judgement whether those threshold criteria have been met does the preparer consider how that element should be measured.

Staff comment: The amendments to paragraph BC58 below were agreed by the IPSASB at its meeting in September 2013. The paragraph is presented in mark-up to allow Members to identify changes from CF-ED2.

~~BC56-BC58.~~ The IPSASB formed a view that, while the adoption of thresholds for recognition purposes may produce information that is understandable, such an approach risks omitting information that is relevant and faithfully representative. Approaches to existence uncertainty based on thresholds may also not meet the QC of comparability, because similar information items may be treated in different ways dependent upon relatively small differences in the probability of a flow of benefits. The IPSASB therefore concluded that, on balance, all available evidence should be assessed in determining whether an element exists and that uncertainty about the flows of service potential or economic benefits should be taken into account in measurement. Guidance may be provided at standards level on dealing with circumstances in which there is significant uncertainty about whether an element exists in particular circumstances, and therefore would satisfy the criteria for recognition.

~~BC57-BC59.~~ The IPSASB explored whether existence uncertainty is specific to certain components of assets and liabilities, in particular for assets whether an entity controls a resource or a right to a resource and for liabilities whether an entity has little or no realistic alternative to avoid an outflow of service potential or economic benefits. The rationale for this approach is that these are the essential characteristics of an asset and a liability where existence uncertainty is likely to arise.

~~BC58-BC60.~~ The IPSASB took the view that, in the context of assets and liabilities, existence uncertainty relates to more than just these characteristics. Existence uncertainty might also relate to the existence of a present obligation and a past event for liabilities and, in particular, whether a ~~present~~ resource that generates future economic benefits or service potential presently exists rather than a future resource or future right to a resource in the context of an asset.

~~BC59-BC61.~~ The IPSASB also took the view that existence uncertainty is not restricted to just assets and liabilities. While changes in other elements are normally accompanied by changes in assets and liabilities, this may not always be the case. The IPSASB therefore rejected an approach whereby discussion of existence uncertainty is restricted to assets and liabilities.

Staff comment: Paragraph BC62 was approved at the September 2013 meeting. It is presented in mark-up here to allow Members to identify changes to CF-ED2.

Measurement Uncertainty

BC62. A range of estimates and measurement techniques may be used to deal with uncertainty associated with the measurement of items that might be presented in the financial statements. In most cases, the application of these measurement and estimation techniques, and the consideration of other relevant information about economic circumstances that exist at reporting date, will result in a measurement that satisfies the QCs. However, in rare circumstances, such as in some legal disputes, it may be that no measure of an asset or a liability would result in a sufficiently faithful representation of that element for it to warrant recognition.

Derecognition

~~BC60-BC63.~~ The IPSASB considered the view that different criteria should be used for initial recognition and derecognition. ~~Many of the respondents to CF-CP2 supported the use of the same criteria for derecognition as for initial recognition.~~ The IPSASB concluded that adopting differential recognition criteria would conflict with the QC of consistency as it would lead to the recognition of items with different standards of evidence for their existence. Many of the respondents to CF-CP2 and CF-ED2 also supported the use of the same criteria for derecognition as for initial recognition.

Alternative Views

Staff comment: The following paragraphs identifying Alternative Views and the appendices identifying differences from IASB and GFS approaches will be deleted from the final Chapter, consistent with the IPSASB's decisions on the form and content of the Conceptual Framework.

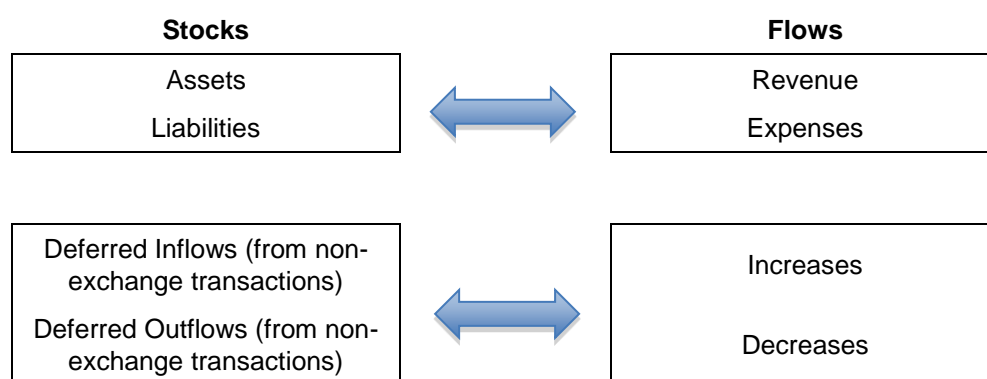
They are retained at this stage to allow Members to refer to them if useful as the approaches to deferred inflows and deferred outflows are finalised.

Alternative View of Prof. Mariano D'Amore

- AV1. This AV does not question the rationale for recognizing deferred inflows and deferred outflows as elements in the financial statements of a public sector entity. Rather, it debates the treatment of deferred inflows and deferred outflows and their related increases and decreases. This member believes that the treatment proposed in the Exposure Draft (ED) substantially modifies the generally understood concepts of revenue and expenses as changes in net assets, and this may have a negative impact on the users' understanding of the entity's financial performance. This AV is based on the assumption that departure from these concepts is not a necessary consequence of the definition of deferred inflows and deferred outflows as separate elements, and that an alternative option may be considered in order to meet the objectives and qualitative characteristics of financial statements. Finally, this AV provides a discussion of the concept of net financial position, since, in this member's opinion, the ED does not give a satisfactory description of the difference between net assets and net financial position, or the relevance of the latter to meeting users' needs.
- AV2. This member believes that the treatment of deferred inflows and deferred outflows stated in the ED implies a misalignment between revenues and increases in net assets on one side, and expenses and decreases in net assets on the other. Based on the definitions given in the ED, a deferred inflow increases net assets in the year in which the inflow is received and subsequently deferred to future periods (in other words, an increase in deferred inflows is an increase in net assets in the current period). In the year in which a decrease in deferred inflows occurs, this is recognized as revenue, although it is not an increase in net assets in the current period. A deferred outflow decreases net assets in the year in which the outflow occurs and is subsequently deferred to future periods (in other words, an increase in deferred outflows is a decrease in net assets in the current period). In the year in which a decrease in deferred outflows occurs, this is recognized as an expense, although it is not a decrease in net assets in the current period. As a consequence, the difference between revenues and expenses (surplus or deficit for the year) is not intended to equal the change that has occurred in net assets in the reporting period. This member questions whether such a misalignment may mislead users, at least in some jurisdictions.

- AV3. In this member's opinion, the effects on the concept and display of financial performance which arise from the proposed treatment of deferred inflows and outflows, and from the new definition of revenue and expenses, are not fully explained in the ED. Indeed for the ED, revenue and expenses are the only two elements in the Statement of Financial Performance. These are used to aggregate and show under the same headings items which share the feature of being flows related to the reporting period, but which are dissimilar in some other relevant respects. Based on the definition provided in the ED, revenues include inflows which are changes in net assets occurring in the reporting period together with others which are solely movements in deferred inflows. Similarly, some of the expenses are outflows which change net assets in the reporting period while some others are simply movements in deferred outflows. All these flows together are balanced to measure the surplus or deficit for the year. This member thinks that such an approach has a negative effect on faithful representation and the ability of users to assess financial performance by considering its different components, i.e. the elements as defined in the ED.
- AV4. It is a generally understood concept that revenue and expenses are flows linked to changes in the stocks of assets and liabilities. So, in this AV, revenues are regarded as aggregating and displaying all, and solely, increases in net assets occurring in the reporting period other than contributions from owners. Similarly, expenses should aggregate and display decreases in net assets occurring in the reporting period other than distributions to owners. Deferred inflows and deferred outflows are still defined as elements in the Statement of Financial Position; thus, they are treated as "stocks" at the end of the reporting period. Increases and decreases in such stocks can be identified as related "flows" occurring in the period. Since deferred inflows and deferred outflows are defined as separate elements from assets and liabilities, increases and decreases in the former should be considered as separate elements from revenue and expenses in the Statement of Financial Performance. Visually (and setting aside ownership contributions/distributions):

Table 1: Elements



- AV5. As the ED makes a distinction between net assets and net financial position, it should follow that changes in both these stocks be distinguished. Nevertheless, the ED only focuses on the entity's surplus or deficit for the year as the "primary indicator" of financial performance. In this member's opinion, change in net assets and surplus/deficit for the year are both relevant performance indicators for accountability and decision-making purposes. Since elements are the basic reference

for recording, classifying and aggregating economic data, the approach of defining increases and decreases in deferred inflows/outflows as distinct elements is intended to keep items contributing to different indicators of financial performance separate. Given that how items are displayed is basically a matter of presentation, from a conceptual point of view the relationship between the elements affecting financial performance can be shown as follows:

Table 2: Relationship between the Elements affecting Financial Performance

	Revenue
Minus	Expenses
Equals	Change in Net Assets
Minus	Increases in Deferred Inflows
Plus	Increases in Deferred Outflows
Plus	Decreases in Deferred Inflows
Minus	Decreases in Deferred Outflows
Equals	Surplus or deficit for the year

AV6. Net assets and net financial position differ only because of the deduction from net assets of deferred inflows and the addition of deferred outflows. Deferred inflows are the result of past increases in net assets; specifically, they can be regarded as the part of the net assets which is to be used by the entity under specified timing restrictions. Thus, it may be argued that deducting deferred inflows from net assets shows the net resources available to the entity with no definite timing restrictions. As for deferred outflows, their addition to net assets provides an indicator of the total net resources available to the entity or which have been provided to third parties for the delivery of future services. Taking into account the combined effects of deferred inflows and deferred outflows on the net financial position, the sense of this indicator seems to be unclear, as it may not include net assets which are still available to the entity (in the case of deferred inflows) while encompassing resources which are no longer under the entity's control (in the case of deferred outflows). Finally, in this member's opinion, net financial position does not substitute net assets nor is it the primary indicator for the assessment of the net resources available to the entity for the provision of services in the future. Disregarding ownership contributions/distributions, net financial position may however be understood as an accumulated surplus or deficit which gives information about the past capacity of an entity to finance the services it has provided through related revenues.

Alternative View of Ms. Jeanine Poggiolini

AV7. Due to the nature of the activities undertaken in the public sector, there is a high prevalence of non-exchange transactions, which are often significant in individual entities. In exchange transactions, the recognition of revenue and expenses is, in most instances, related to the performance by the parties to the transaction. Due to the inherent nature of non-exchange transactions, there is often no performance required by, or imposed on, the parties to the transaction. To ensure that users of the financial statements have relevant information for decision-making or accountability purposes, these types of transactions require specific consideration by the Board.

AV8. The ED identifies deferred inflows and deferred outflows as separate elements. These elements result from inflows and outflows in non-exchange transactions, where the flows relate to a future period. This member disagrees with the view that deferred inflows and deferred outflows should be identified and recognized as separate elements. Instead, these flows should be included in the definitions of revenues and expenses.

- AV9. From a revenue and deferred inflow perspective, when an entity demonstrates control over a resource, and the inflow is not an ownership contribution and no related obligation exists, then revenue should be recognized. Where an entity controls the underlying resource and has no related obligation, it has the ability to direct the nature and manner of use of the resulting economic benefits or service potential. As the entity has the ability to control the resource by deciding how, for what and when it can use the associated benefits, it should recognize revenue at that point. The opposite is true for expenses and deferred outflows. If an entity has an outflow of resources over which it has no further control, through, for example, the existence of rights, then an expense should be recognized. In this member's view, this position more appropriately demonstrates the resources for which the entity is accountable.
- AV10. In addition, the existence of other elements in the Framework is based on the occurrence of a past transaction or event. Deferred inflows and deferred outflows, and their subsequent recognition as revenues or expenses, however arise as a consequence of time or the passage of time. In this member's view, this is not a sound basis for delaying the recognition of revenues and expenses. One of the reasons for delaying the recognition of these revenues and expenses is so that they are used in the period stipulated by the transferor. However, an entity need not use the resources in that period for revenue or expenses to be recognized in that period. This reinforces the view that control either existed or was lost in earlier reporting periods.
- AV11. It is however acknowledged that, in certain instances, this approach may result in large surpluses or deficits being reflected in the statement of financial performance. This could be addressed through developing appropriate presentation and disclosure requirements at standards level which would provide relevant information to users of the financial statements. At a more fundamental level, the concepts outlined in the Conceptual Framework should be based on principles that can be applied to a range of transactions and events. As a consequence, these principles should be transaction neutral and, should not distinguish between exchange and non-exchange transactions. Moreover, the principles should not be designed and defined in a way so that a specific outcome is achieved for a specific group of transactions.

Appendix 1A

The IASB Conceptual Framework (September 2010)

Elements and Recognition in Financial Statements

The International Accounting Standards Board (IASB) develops and publishes International Financial Reporting Standards (IFRSs). IFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities.

The IASB Conceptual Framework (issued in 1989 and updated in part in September 2010)⁸. It explains:

- The underlying assumption that financial statements are prepared on a going concern basis.
- Financial statements portray the financial effects of transactions and other events by grouping them into broad classes, termed the elements, according to their economic characteristics.
- The elements directly related to the measurement of financial position in the balance sheet are assets, liabilities and equity. Equity is the residual interest in the assets of the entity after deducting all its liabilities.
- The elements directly related to the measurement of performance in the income statement are income and expenses.
- Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition namely it is probable that any future economic benefit associated with the item will flow to or from the entity and the item has a cost or value that can be measured with reliability.

⁸ The IASB has recently reactivated its Conceptual Framework project. Elements and Recognition is under consideration as part of that project.

Appendix 1B

Statistical Reporting Guidelines of the 1993 System of National Accounts (updated 2008) and Other Guidance derived from it (ESA 95 and GFSM 2001)

Flows and Stocks

The 1993 System of National Accounts (SNA) – as updated in 2008 (SNA 2008):

- Describes the flows and stocks that are recorded in the national economy, including the general government sector and other sectors of the economy. For Government Finance Statistics (GFS) the system explains that all data on units of the general government sector are either flows (mostly transactions) or stocks (assets, liabilities and net worth) before summarizing the accounting rules to record the stocks and flows.
- Covers concepts, definitions, classifications and accounting rules.
- The elements directly related to the measurement of performance in the income statement are revenue and expenses.
- Defines the assets and liabilities included in the system, provides a classification of types of assets and liabilities, and describes the content of each classification category.
- Defines revenue, provides a classification of types of revenue and the contents of each classification category.
- Defines expense and explains the classification between functional and economic expense and the contents of each category.

The GFSM 2001 and ESA 95 are consistent with the principles of the 1993 SNA. However, at a detailed level, some reporting differences may arise as a result of differences in purpose and specific data needs.

The GFSM 2001 and ESA 95 are currently under revision to bring them into line with the 2008 SNA.

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Agenda Item 6B.4

Draft minutes of IPSASB Meeting (September 2013)

Draft minutes of IPSASB meeting September 2013

Conceptual Framework CF–ED2: Elements and Recognition–Further Analysis of Responses

Members considered staff papers which included:

- An analysis of the application of the Conceptual Framework Exposure Draft (CF–ED2), *Elements and Recognition in Financial Statements* and the Alternative Views in CF–ED2, and the measures of surplus(deficit), net assets and net financial position that would be presented in the statement of financial performance and financial position in different circumstances;
- Additional analysis of responses to CF–ED2; and
- Proposed amendments to CF–ED2 to give effect to the decisions of the IPSASB at its June 2013 meeting and additional issues identified by respondents to CF–ED2.

Deferred Inflows and Deferred Outflows

Members noted that:

- A majority of respondents opposed the identification of deferred inflows and deferred outflows as elements. However, a number of these respondents acknowledged the issue that the introduction of these elements was intended to respond to and agreed that there is value in providing information on deferred items; and
- Respondents that opposed the identification of deferred inflows and deferred outflows as separate elements had different views about the treatment of deferred items, as follows:
 - Some were of the view deferred items that did not satisfy the definitions of assets or liabilities should be recognized as revenues or expenses;
 - Some were of the view that the deferred items should be embraced within the definitions of assets and liabilities; and
 - Others expressed support for either Alternative View 1 or 2.

Members briefly discussed the analysis of measures of financial performance and net financial position that would result from application of CF–ED2 and the Alternative Views to the examples considered in the staff paper. The Chairman noted that in some jurisdictions, the deferred items may be accounted for in a manner that was different from that identified by CF–ED2 or the Alternative Views. For example, deferred inflows may be treated as a separate class of liabilities, or a separate class of obligations. Some Members noted that they had also had experience of circumstances in which deferred inflows were accounted for in this manner. They also noted that the implications of identification of particular classes of flows or stocks as elements was not always clear, and subject to different interpretations, including whether the financial statements may recognize and present items that did not satisfy the definition of an element. Consequently the issues facing the Board were more complex than simply deciding whether to adopt the CF–ED2 approach or one of the approaches identified in the Alternative Views.

Members discussed the views and concerns of respondents regarding the identification of deferred items as separate elements and their consequences for measures of financial performance and net financial position that would be presented in the statement of financial performance and the statement of financial position. Some Task Based Group (TBG) and other IPSASB Members also noted that they shared

concerns about some aspects of the CF–ED2 proposals regarding the identification of deferred items as separate elements and/or how those elements were defined.

Members noted that:

- Chapter 2 of the Conceptual Framework explains that the financial performance of most public sector entities will not be fully or adequately reflected in any measure of financial results presented in financial statements, and will need to be assessed in the context of, for example, the achievement of service delivery objectives, compliance with approved budgets, and prospective financial information; and
- The Consultation Paper, *Conceptual Framework For General Purpose Financial Reporting By Public Sector Entities: Elements and Recognition in Financial Statements*, identified two broad measures of financial performance that might be reflected in financial statements—measures that focused on either (a) the change in net assets during the period; or (b) the inflow and outflow of resources that were more closely associated with activities of the reporting period.

Some Members expressed the view that both measures of financial performance in the Consultation Paper are relevant and useful to users, and expressed some concern that the Conceptual Framework should specify that the concept of financial performance that is to be presented in the primary financial statements is only one (and not both) of these measures.

Members noted their views on how this aspect of the proposals in CF–ED2 might be further developed, including the following revisions to CF–ED2 approach proposed by staff and the TBG:

- A presentational approach which would identify and describe time stipulated inflows and outflows that did not satisfy the definitions of assets or liabilities as separate classes of revenue or expense and confirm that the separate disclosure of this class of revenue or expense had information value. The statement of financial performance would then identify as separate identifiable components of revenues and expenses those inflows and outflows that that were subject to time stipulations. The statement of financial position would also identify the assets that were subject to time stipulations; and
- An approach that disengaged the identification and definition of the elements from issues related to their presentation, and refocused this proposed Chapter of the Conceptual Framework on only the identification and definitions of the elements. Such an approach would:
 - Identify the elements of financial statements as assets, liabilities, revenue, expenses, ownership contributions and ownership distributions and acknowledge that certain deferred items that did not satisfy the definition of an element may also be presented in the financial statements. The IPSASB agreed that whether or not these deferred items should be identified as separate elements, their key characteristics and how they should be defined would be further considered at the next meeting;
 - Not specify the measure (or measures) of financial performance that is to be reflected in the financial statements;
 - Not specify the financial statements in which each element would be recognised. This would allow for the ongoing development of the mechanism for presenting financial information by the IPSASB in the future—including developments in the contents and type of financial statements that might present information about financial performance; and

- Acknowledge that how the elements may be “assembled” to present information about financial performance and financial position would be further developed at standards level.

The composition and type of the financial statements that would be used to present the elements would then be specified at standards level, may evolve over time and may be influenced and enhanced by jurisdictional considerations.

The IPSASB agreed to consider these approaches at the next meeting and directed staff and the TBG to prepare a paper which further developed and explained the approaches.

The IPSASB then continued its review of responses to the other SMCs, and staff’s proposed amendments to CF–ED2 to give effect to decisions made at the June 2013 IPSASB meeting. Members noted that these amendments were identified in the marked-up draft of CF–ED2 at Agenda Item 4A.3.

SMC 1–Definition of an Asset

Relationship of the definition of an asset to the explanation of a resource

Staff reported that some respondents had expressed a concern that there is overlap between the definition of an asset paragraph 2.1 and the explanation of a resource in paragraph 2.2 and in its current form the explanation of a resource blurs the distinction between an asset and a resource. Staff proposed that the phrase “...with the ability to provide an inflow of service potential or economic benefits” be removed from the definition of an asset, because paragraph 2.2 makes it clear that this is the characteristic of a resource and consequential amendments be made to paragraphs 3.13 and BC 24 to clarify and confirm that a present obligation involves an outflow of resources from the entity. The IPSASB agreed with the broad direction of the amendments proposed by staff but directed that the second sentence of paragraph 2.2 and the subheading “Service Potential or Economic Benefits” prior to paragraph 2.3 should be deleted.

Terminology: “services” rather than “goods and services”

Staff noted that in finalizing Chapters 1–4 of the Conceptual Framework and in developing early drafts of the proposed Preface to the Conceptual Framework, the IPSASB directed that references should be made to “services” rather than “goods and services”. Consequently, the text of this Chapter of the Conceptual Framework had been amended for consistency in terminology. The IPSASB agreed with the editorial amendments as proposed by staff and directed that the first reference to “services” in this Chapter be supported by a footnote which identified that the term “services” encompasses “goods and services”. Members noted that such a footnote could usefully be relocated to Chapter 1 of the Framework when the final Framework encompassing all Chapters is issued.

Explanation of Control

Staff reported that some respondents had expressed the view that the discussion of control in Paragraph 2.6(b) of CF–ED2 is very broad and focuses on only the power to control, without acknowledging that the controlling entity must be able to derive benefits from the resource. Staff proposed that paragraph 2.6(b) be revised to reflect that control enables the entity to derive the benefits of the resource in the achievement of its service delivery or other objectives. After some discussion the IPSASB agreed the revised wording of Paragraph 2.6(b) as proposed by staff except that reference to “at the reporting date” in the first sentence is to be deleted.

Inflows of service potential and economic benefits

At its June 2013 meeting, the IPSASB noted that several respondents proposed inserting “future” before “inflows” in the definition of an asset. The IPSASB directed that “future” was not to be included in the definition of an asset, but the Basis for Conclusions was to explain that inflows contribute to operating capacity and therefore the ability of an entity to deliver services in the future. The IPSASB agreed with the amendment to Paragraph BC 3 proposed by staff to respond to this direction.

Staff reported that some respondents also expressed a concern that reference to the ability to provide “an inflow” of service potential or economic benefits appears to describe a future resource rather than a present resource that the entity controls. Some of these respondents also noted that this reflects that an asset delivers an inflow of service potential to the entity, rather than an entity using its service potential to provide services to the community. These respondents advocate that it would be clearer to explain that an asset is a resource that represents or has the capacity to provide service potential or economic benefits. Staff noted that CF–ED2 does not refer to the ability to provide “an inflow” of service potential or economic benefits in describing resources or assets, or explain the significance of this term and proposed its deletion. The IPSASB agreed with the staff proposal that “an inflow” be deleted from the revised description of a resource in paragraph 2.2.

Risks and Rewards as an Indicator of Control

At the June 2013 meeting, the IPSASB noted that 2 respondents had suggested adding risks and rewards to the list of indicators of control in paragraph 2. However, the IPSASB decided that including references to risks and rewards as indicators of control was not appropriate for the main text, but there should be a more detailed explanation given of the reason in the Basis for Conclusions. The IPSASB agreed with the amendments to BC 16 proposed by staff to give effect to this direction.

Unconditional Rights

At the June 2013 meeting, the IPSASB noted that 2 respondents had expressed concern that the explanation in BC 6 that:

- Unconditional rights “*may give rise to assets, if the entity has paid for them or if the unconditional right has acquired an identifiable value in an open, active and orderly market*”, may be read as not reflecting the principles established in the definition of an asset; and
- The observation that “*...identification of circumstances where unconditional rights give rise to an asset is a standards level issue*”, did not provide a link to, or acknowledge, the conceptual underpinnings that would provide guidance to the standards level discussion.

The IPSASB agreed to revisit the explanation of unconditional rights at this meeting. Staff proposed that to respond to the concerns identified by these respondents paragraph BC 6 should confirm that to qualify for recognition unconditional rights would need to satisfy the definition of assets and the recognition criteria. Members discussed the revisions to BC 6 proposed by staff. Staff noted that one TBG member had expressed concern that the revisions may be read as allowing a wide range of rights with dubious capacity to enhance the service potential or economic benefits of the entity to be recognized as assets. The IPSASB agreed with the amendment proposed by staff except that the final two sentences, which referred to circumstances in which the recognition criteria were likely to be met, are to be deleted.

Executory Contracts

At the June 2013 meeting, the IPSASB noted that some respondents expressed reservations about the explanation in Paragraph BC 7 that recognition of the rights and obligations related to executory contracts

should be determined at standards level. Staff noted that underpinning the concern of these respondents is a view that whether assets and liabilities arise from unconditional rights and obligations reflected in executory contracts should be driven by an assessment of whether those rights and obligations satisfy the definitions of the elements in the Conceptual Framework. Members reviewed staff proposed amendments to paragraph BC 7 to respond to these concerns and confirm that the IPSASB has the capacity to respond at standards level to concerns about the adverse impact on understandability that recognizing gross amounts of any elements might have. Members discussed the amendments to Paragraph BC 7 proposed by staff. The IPSASB agreed those amendments except that the phrase “conditional and unconditional” in the first line of the additional sentences proposed by staff is to be deleted.

SMC 2 (a)–Definition of a Liability & 2 (b)–Description of Non-Legal Binding Obligations

Relationship between a liability and a present obligation and related terminology

Staff noted that the explanation of a present obligation in paragraph 3.2 of CF–ED2 duplicates some parts of the definition of a liability in paragraph 3.1, and proposed paragraph 3.2 be revised to reflect the approach proposed to establish the relationship between the definition of the asset and the description of a resource (see above). Members reviewed the amendments proposed by staff and directed that further amendments be made to paragraphs 3.1 and 3.2 to more closely reflect the structure adopted for the definition of an asset and explanation of a resource. To that end the IPSASB agreed that the definition of a liability and the description of a present obligation be redrafted to focus more sharply on a liability of an entity being a present obligation for an outflow of resources that arises from a past event. Paragraph 3.2 would then be restructured to describe a present obligation as a legal or other binding requirement which an entity has little or no realistic alternative to avoid.

At the June 2013 meeting, the IPSASB noted that a number of respondents expressed concern that the term “non-legal binding requirement” could be interpreted as referring to requirements that were illegal and directed staff and the TBG to identify an alternative term. Staff proposed that the term “other binding requirement” be adopted as this appears to embrace a range of circumstances that may give rise to present obligations in different jurisdictions, and avoid any inappropriate interpretation. The IPSASB agreed that this term be adopted for the first draft of the final chapter and that references to “non-legal binding requirements” be replaced by the phrase “other binding requirements”.

Little or No Realistic Alternative

At the June 2013 meeting, the IPSASB noted concerns raised by respondents regarding the term “little or no realistic alternative” in the proposed definition of a liability. After some discussion the IPSASB agreed to delete the two words “little or” from the definition and to strengthen the explanation in the Basis for Conclusions. Consistent with that decision, staff amended the phrase “little or no realistic alternative to avoid” to read “no realistic alternative to avoid” wherever it appeared in CF–ED2, and included an explanation of the reasons for the change at Paragraph BC 29. However, the IPSASB noted concerns of the TBG and staff that deletion of the words “little or no” meant, or may be interpreted to mean, that a liability could only arise when the outflow of resources was, in effect, virtually certain and this raised the threshold beyond that intended by the IPSASB. The IPSASB agreed this was not the intended outcome of the amendment and directed that the words “little or no” be reinstated.

Economic and Political Coercion

Members noted that following on from discussion at the June 2013 meeting, paragraph 3.7 had been amended to reflect that enforceability does not include economic nor political coercion but that such

coercion may lead to a liability arising from a non-legal binding obligation. At this meeting the IPSASB confirmed the sentiments of the amendments to paragraph 3.7, but expressed some concern that “political coercion” would not translate well in all languages and directed staff to consider whether alternate wording may equally or better reflect the sentiment intended.

Conditional and Unconditional Obligations, Stand-ready Obligations and Performance Obligations

Members noted that a number of respondents did not agree with the explanation in CF–ED2:

- Paragraph BC 22: that distinguishing between conditional and unconditional obligations is not useful for defining a liability because a conditional obligation can give rise to a liability; and/or
- Paragraph BC 24: that the notion of a stand-ready obligation does not work well in a public sector non-exchange context because it is very difficult to distinguish a stand-ready obligation from other conditional obligations and the issue of liabilities arising from social benefits should be considered at the standards level.

At its June 2013 meeting, the IPSASB agreed to retain the explanations in paragraphs BC 22 and BC 24 of CF–ED2, but that that the Basis for Conclusion should be further developed to reflect public sector circumstances that can impact on the interpretation of terms such as stand-ready obligations. At this meeting the IPSASB reviewed staff proposed amendments to paragraphs BC 22, BC 24 and BC 26 intended to draw out the complexity of public sector circumstances and acknowledge that, while guidance on accounting for particular arrangements may be identified as a standards level issue, whether obligations and liabilities arise from those arrangements will depend on whether they satisfy the definition and recognition criteria in the Framework. Staff noted that the amendments are also intended to overcome concerns that the original wording of these paragraphs may have been interpreted as presenting unintended obstacles to the IPSASB developing guidance on what may be described as stand-ready obligations or performance obligations in the future.

Members discussed the proposed amendments and noted the explanation of tentative positions reached and matters still under consideration by the IASB in respect of conditional and unconditional obligations and stand-ready obligations as explained in the IASB Discussion Paper “*A Review of The Conceptual Framework for Financial Reporting*”. After some discussion, the IPSASB agreed the amendments proposed by staff.

Commitments

At its June 2013 meeting, the IPSASB noted that some respondents had commented that commitments are not mentioned in the Framework although they are very significant in the public sector. The IPSASB directed that consideration should be given to acknowledging commitments in the Basis for Conclusions and explaining that commitments are only liabilities if they meet all components of the definition of a liability. The IPSASB reviewed and agreed the inclusion of an additional paragraph proposed by staff to acknowledge the nature and role of commitments in the public sector.

SMC 3–Definition of Revenue & SMC 4–Definition of Expenses

At its June 2013 meeting, the IPSASB noted that:

- A majority of respondents did not agree with the definitions of revenue and expense; and
- The major reason for this disagreement was because of the consequences for the definitions of revenue and expenses of the proposal to identify deferred inflows and deferred outflows as elements.

Members noted that how to respond to a number of matters raised by respondents should be revisited as the IPSASB moved closer to a decision on whether to identify deferred inflows and deferred outflows as elements and how to define those elements. However, Members noted that some respondents had proposed that the Conceptual Framework should require, clarify or provide more detailed guidance on the following matters, and agreed with the staff view that these matters were better dealt with at standards level:

- The triggering event for recognition of revenue and expense; and
- Separate presentation of operating and capital revenue and expense.

Members also discussed the following proposals for change to the definitions, explanation or description of revenue and expenses and agreed that the changes should not be made:

- Replace the terms “revenue” and “expenses” with “gains” and “loss”, or replace “revenue” with “income”;
- Include in the explanation of revenue a reference to sovereign revenue; and
- Remove references to ownership contributions and ownership distributions from the definitions of revenue and expenses.

Staff noted that some respondents suggested expanding the definitions of revenue and expenses to provide for revaluations or enhancements of assets and liabilities. One respondent did not support the definitions of revenue and expenses in CF–ED2 because they already encompassed unrealized gains and losses on assets and liabilities. Staff also noted that some respondents had expressed the view that the meaning of “inflows” and “outflows” should be clarified. To respond to these concerns staff proposed that the meaning of “inflows” and “outflows” in the definition of revenue and expenses and its relationship to paragraph 4.5 which establishes that revenue and expenses include all changes in net assets other than ownership contributions, ownership distributions, deferred inflows and deferred outflows should be clarified.

The IPSASB agreed to revisit this matter as its approach to identification of the elements of financial statements and notions of financial performance were further developed.

Revenues and Expenses arising from Fee for Service and Subsidized Activities

Paragraph BC 36 explains that the IPSASB considered whether revenue should be defined as the gross or net amount of the increase in net assets, and decided to define it as the increase in the net amount. BC 36 also explains that standards may require the gross presentation of the relevant flows on the face of the financial statements in certain circumstances, such as the sale of inventory. Staff proposed that BC 36 be expanded to encompass some common public sector transactions and arrangements—for example, to explain that while the provision of services on a “full fee for service” basis to constituents or circumstances in which one party subsidizes part (or all) of the cost of delivery of particular services by a government entity may not give rise to an increase (or decrease) in net assets, gross presentation may be required by particular standards. The IPSASB decided that BC 36 should not be amended to include references to such circumstances because the inflows and outflows of resources that resulted from such transactions were separate components and would separately increase and decrease net assets, therefore revenue and expenses would also be the gross amount of those inflows and outflows.

SMC 6—Net Assets, Net Financial Position, Ownership Contributions, Ownership Distributions and Ownership Interests

Net Assets and Net Financial Position

Members noted that a majority of respondents agreed with the description of net assets but not with the description of net financial position, and most respondents that opposed the description of net financial position also opposed the introduction of deferred inflows and deferred outflows. Staff noted that some respondents questioned the description of positive and negative net financial position in paragraph BC 47 and advocated that the relationship between net assets and net financial position be further clarified. A respondent also noted that the term “net financial position” is very similar to the term “net financial worth” in the Government Financial Statistics Manual although they mean different things.

Staff proposed amendments to BC 47 intended to clarify the interpretation of net financial position and its relationship to net assets and proposed that clarification of any potential confusion between the meaning of net financial position and net financial worth be considered following the IPSASB’s decision on the identification of deferred inflows and deferred outflows as elements.

The IPSASB agreed that the sections of CF–ED2 dealing with net financial position should be revisited as its approach to identification of the elements of financial statements and notions of financial performance were further developed at the next meeting.

Ownership Contributions and Ownership Distributions

At the June 2013 meeting, the PSASB considered responses relating to ownership contributions and ownership distributions and confirmed that ownership contributions and ownership distributions should continue to be identified as elements of the financial statements.

Members also noted that a respondent had proposed that, to avoid confusion, there was a need to clarify how the transfer of assets and liabilities between public sector entities referred to in the second sentence of Paragraph 6.5 would be accounted for—or at least explain that the treatment of these transfers would be addressed at a standards level. Staff proposed that, if retained, this sentence be clarified by explaining that ownership contributions can arise from the transfer of assets and liabilities between public sector entities for no consideration and that detailed guidance should be addressed at standards level. Staff also requested the IPSASB to consider whether the sentence is necessary since the circumstances dealt with in paragraph 6.5 appear to be encompassed by explanation in paragraph 6.6. The IPSASB noted that respondents had not proposed deletion of the sentence and agreed it should be retained and modified as proposed by staff.

Ownership contributions and ownership distributions as elements of the statement of financial position.

Staff noted that paragraphs 1.2 and 6.2 of CF–ED2 specify that ownership contributions and ownership distributions are elements in the statement of financial position. Staff questioned whether ownership contributions and ownership distribution were more appropriately identified as elements of a “flow” statement, such as a statement of changes in net assets as is currently included in the suite of IPSAS financial statements. Staff noted the comments of some respondents also reflect some concern with the designation of these items as elements of the statement of financial position

Members noted that at the next IPSASB meeting it would consider whether this Chapter of the Conceptual Framework should be refocus on defining the elements without specifying the financial statements in which each element would be recognised. The IPSASB agreed to revisit this matter after that consideration.

SMC 7–Recognition

At its June 2013 meeting, the IPSASB decided that it was not appropriate to specify recognition thresholds in a Conceptual Framework, and directed that the Basis for Conclusions should include:

- An acknowledgement that thresholds dealing with existence uncertainty may be developed at standards level; and
- As an example of measurement uncertainty, an example of a legal case where the outcome was unknown.

Staff also proposed that in response to a concern raised by a respondent, paragraph 7.5 of CF–ED2 should include a reference to the QCs rather than just to relevance and faithful representation.

Members reviewed an additional paragraph staff proposed be included in the Basis for Conclusions to give effect to these clarifications. The IPSASB approved the clarifications but directed that the phrase “unspecified amounts of damages” should be deleted from the text of the additional paragraph.

The Next Meeting

The Chair noted that it was intended that at the next meeting the IPSASB would consider revised approaches to the deferrals issue. A draft of the “elements and recognition” chapter of the Conceptual Framework reflecting the IPSASB’s decisions on this and other matters would then be prepared for review at the March 2014 meeting.

The Chairman also noted that the IPSASB had now considered the substantial issues identified by respondents, even if the IPSASB had not been able to respond in the manner proposed by the respondent in all cases.

Staff advised that respondents had also identified a number of editorial and other sharply focused drafting issues intended to ensure the definitions and their explanation achieve the result intended by the IPSASB. These matters will be brought to the attention of the IPSASB as it reviews the draft Chapter. Staff also noted that it will continue to revisit responses to CF–ED2 as this phase of the Framework is developed to ensure that issues relevant to proposed developments are not overlooked.

One Member noted that, whatever the final decision of the IPSASB in respect of the approach adopted to identification of deferred items as elements, it was important that the Basis for Conclusions acknowledged the discussion at this meeting of such matters as whether:

- Revenue and expenses should be defined as period flows or a change in net assets;
- This Chapter of the Conceptual Framework should focus on only the definition and explanation of the elements without specifying the financial statements in which those elements are to be recognised; and
- Both notions of financial performance identified in the Elements Consultation Paper (and perhaps other notions of financial performance) may be relevant and useful to users and should not be excluded from representation in the financial statements as a result of decisions made about the focus of this Chapter of the Conceptual Framework.

The IPSASB agreed that the Basis for Conclusions should include such acknowledgement.