

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Toronto, Canada

Meeting Date: March 11-14, 2014

Agenda Item 4A

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 **confirm** the approach to deferred inflows and deferred outflows in the Framework; and
 - (b) To **consider** an Issues Paper on the r draft of Chapter 5 and **provide** final directions on those issues; and
 - (c) To **review** a draft of the final chapter and **provide** directions for further development and finalization.

Material(s) Presented

Agenda Item 4A.1	Issues Paper on <i>Development of Option D: Other Economic Phenomena that Do Not Meet the Definition of an Element</i>
Agenda Item 4A.2	Issues Paper on Draft of Chapter 5, <i>Elements and Recognition in Financial Statements</i>
Agenda Item 4A.3A	Marked-up Draft of Chapter 5, <i>Elements and Recognition in Financial Statements</i>
Agenda Item 4A.3B	Clean Draft of Chapter 5, <i>Elements and Recognition in Financial Statements</i>
Agenda Item 4A.4	Draft Minutes December 2013 Meeting
Agenda Item 4A.5	Minutes September 2013 Meeting

Conceptual Framework Issues Paper on Development of Option D: Other Economic Phenomena That Do Not Meet the Definition of an Element

Objectives of Issues Paper

1. This aim of this Issues Paper is to provide information so that the IPSASB can confirm how it wants deferred inflows (DIs) and deferred outflows (DOs) and related issues to be addressed in the Framework.

Nature and Structure of Paper

2. This Issues Paper develops the option for dealing with deferred inflows and deferred outflows that the IPSASB agreed at its December 2013 meeting: Option D: *Other Economic Phenomena not Meeting the Definition of an Element*. This paper is informed by the views of the Phase 2 Task Based Group (TBG) formulated at its teleconference on February 4, 2014
3. The background section provides a detailed explanation of how the IPSASB's views about financial performance and DIs and DOs have developed since 2009. This focuses on the discussion in the key publications, Consultation Paper, *Elements and Recognition in Financial Statements* (CF-CP2) and the proposals in Exposure Draft, *Elements and Recognition in Financial Statements* (CF-ED2). The paper then addresses:
 - Decisions made by the Board at the December 2013 meeting; and
 - Key Issues discussed by the Phase 2 Task Based Group (TBG) in developing these agenda papers

Background

Conceptual Framework Consultation Paper, Elements and Recognition in Financial Statements (CF-CP2)

4. CF-CP2, which was issued in December 2010, discussed two contrasting approaches to financial performance:
 - An approach that measures financial performance as the net result of all changes in the entity's resources and obligations during the period (described as the asset and liability-led approach (A & L-led approach))¹; and
 - An approach that measures financial performance as the result of the revenue inflows and expense outflows more closely associated with the operations of the current period (described as the revenue and expense-led approach (R & L-led approach)).
5. CF-CP2 noted that the two different approaches could lead to different definitions of the elements related to financial performance and financial position. The R & E-led approach is strongly linked to the notion of inter-period equity. Inter-period equity refers to the extent to which the cost of providing programs and services in the reporting period is borne by current taxpayers and current

¹ The reference should probably have been to "present resources" and "present obligations"

resource providers. The A & L-led approach is linked to the notion of changes in resources available to provide services in the future and claims on these resources as a result of period activity.

6. A further section of CF–CP2 discussed “Other Potential Elements” and pointed out that, if IPSASB adopted the R & L-led approach, IPSASB would need to address deferred flows. Under this approach deferred flows are items that do not meet the proposed definitions of revenue and expense, but which are nevertheless considered to affect the financial performance of the period. CF–CP2 identified three options for dealing with deferred flows:
 - Defining DIs and DOs as elements on the statement of financial position;
 - Broadening the asset and liability definitions to include items that are deferrals; and
 - Describing deferred flows as sub-classifications of net assets/net liabilities (subsequently referred to as the residual amount)
7. CF–CP2 had two specific matters for comment (SMC) on these areas. The first asked constituents to indicate whether they preferred the A & L-led or R & E-led approach and to indicate the most important arguments. The second asked whether deferrals need to be identified on the statement of financial position. If respondents supported such identification they were asked to indicate which of the three approaches in paragraph 6 they supported.
8. The responses to these SMCs were inconclusive and inconsistent. A small majority of respondents expressing a view favored the A & L-led approach. However, a number of respondents who supported the A & L-led approach also indicated that they favored identifying deferrals on the statement of financial position. Defining DIs and DOs as separate elements received more support than the other two options highlighted in paragraph 5, but this was only 20% of overall respondents. The response did not provide any new insights to the issue of what model of financial performance should be reflected in the financial statements beyond those discussed in the CP.

Conceptual Framework Exposure Draft, Elements and Recognition in Financial Statements (CF–ED2)

9. Following extensive discussions both within the TBG and at IPSASB meetings in the second half of 2011 and the first half of 2012 the IPSASB issued CF–ED2. CF–ED2 expressed a view that it is important to be able to distinguish flows that relate to the current reporting period from those that relate to specified future reporting periods. CF–ED2 therefore proposed definitions of a DI and a DO as follows:
 - *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; and*
 - *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.*
10. The two key features of these definitions were;
 - i. The proposed elements were restricted to non-exchange transactions; and
 - ii. The flows had to be related to a specified future period.

11. The IPSASB's rationale for including these characteristics were as risk-avoidance measures to (i) reduce the possibility of DIs and DOs being used widely as smoothing devices and (ii) to ensure that DIs and DOs are not presented on the statement of financial position indefinitely. Two Alternative Views (AVs) contested the approach to DIs and DOs.
12. A SMC in CF–ED2 asked constituents whether they agreed with the decision to define DIs and DOs as elements. Respondents who supported the decision to define DIs and DOs were further asked whether they specifically supported the restriction to non-exchange transactions and more broadly whether they supported the proposed definition.
13. Most of the respondents to CF–ED2 disagreed with defining DIs and DOs as elements. Under a third of respondents to CF–ED2 supported defining DIs and DOs as elements. Many of those respondents opposed to these elements, expressed reservations about the implications for convergence/alignment with the International Accounting Standards Board's Conceptual Framework, and International Financial Reporting Standards more generally. A number of respondents considered that the proposed approach did not reflect economic reality and that it would be more difficult to determine an objective basis for deferring revenue and expenses under the R&L-led model. Nevertheless, a number of respondents also expressed the view that information on flows relating to particular reporting periods has information value.
14. The rationale for restricting the definitions to non-exchange transactions was challenged both by respondents who favored defining DIs and DOs as elements and those opposed to these elements on the grounds that the rationale for excluding exchange transactions was conceptually weak. Respondents also challenged the restriction to specified time periods because it would potentially lead to the different accounting treatment of very similar transactions dependent upon whether a specific period was identified; i.e., a grant without conditions receivable by an entity to finance its general activities for a five year period would have met the definition of a DI, whereas a similar grant for a future unspecified period would have met the definition of revenue.
15. The IPSASB had to decide how to proceed in drafting the chapter on elements and recognition. The IPSASB needed to balance the limited support for the proposals on deferred flows in CF–ED2, with a view that it needed to respond to the perceived need of users for information about flows relating to particular reporting periods.

September 2013 Meeting

16. At the September 2013 meeting the IPSASB considered a proposal that the chapter on elements should (a) not specify the measure (or measures) of financial performance that is to be reflected in the financial statements and (b) not specify the financial statements on which each element is to be recognized. It was thought that this would allow for the ongoing development of methods of presentation of the elements at standards level and not necessarily preclude presentation of the measures of performance based on both (i) movements in resources and claims on those resources in the reporting period and (ii) flows relating to the reporting period. The IPSASB directed the TBG to develop options for consideration at the December meeting.

Discussion and Decisions at the December 2013 Meeting

17. At the December 2013 meeting the IPSASB considered five options:
- A. Defining DIs and DOs as elements in a more principles-based manner and not specifying the financial statements in which the elements are to be recognized. As such, the Chapter would not predetermine the 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;
 - D. Accepting that certain economic phenomena that do not meet the definition of any element may need to be recognized in financial statements in order to meet the objectives of financial reporting; and
 - E. Reporting inflows and outflows that provide service potential or economic benefits, but do not affect assets and liabilities as defined in the Framework and reporting inflows and outflows that do not affect revenue and expenses

Option E

18. Under Option E revenue and expenses are sub-sets of broader inflows and outflows. DIs and DOs would not be defined under Option E. Option E was not accepted, largely because of its complexity (see paragraph 24 below for similarities between Option E and Option D). The IPSASB then considered Options A to D above.

Option A

19. Option A differed from the approach in CF–ED2 because the definitions of Dis and DOs would (i) not be restricted to non-exchange transactions and (ii) there would not be a requirement that the flows be linked to specified future reporting periods. These changes were intended to address some of the concerns expressed by respondents to CF–ED2 noted in paragraph 14.

Option B

20. Under Option B 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 are considered to meet definitions of revenues and expenses derived from the asset and liability definitions.
21. Option B is underpinned by the view that the fact that DIs and DOs arise as a consequence of time or the passage of time is not a sound basis for delaying the recognition of revenues and expenses. Under Option B delaying the recognition of revenues and expenses until resources are used in the period stipulated by the transferor is unjustifiable, because an entity need not use the resources in that period. Option B adopts a view that control of such resources either existed or was lost in earlier reporting periods.
22. Option B had two presentational variants. Under the first variant deferred flows that met the definition of revenue and expense would be presented in surplus or deficit for the reporting period. This approach reflected the Alternative View of Jeanine Poggiolini in CF–ED2. Under the second variant deferred flows would be initially recognized in residual amount (net assets/liabilities) and recycled to surplus/deficit as time stipulations occur.

Option C

23. Option C addressed the issue of deferrals by broadening the definitions of an asset and a liability to include references to deferred credits (liabilities) and deferred debits (assets) or similar terms, rather than by creating new elements. Illustrative examples of modified definitions were:
- *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.*

Option D

24. Under Option D six elements are defined; an asset, a liability, revenue, expenses, ownership contributions, and ownership distributions. Option D would not define DIs and DOs as elements. However, 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.

IPSASB's Views: December 2013

25. Following discussion and a process of informal voting Members eliminated Option C and both variants of Option B. In a final round of informal voting Members decided to adopt **Option D** rather than Option A. Some members expressed reservations that Option D was insufficiently developed and stated that their support was contingent on a more detailed explanation of certain factors. Members directed the staff and the TBG to further develop Option D for the March 2014 meeting, in particular the impact of Option D on the definitions of an asset, a liability, revenue and expenses and approaches to surplus/deficit and financial performance.

Key Issues in Option D

26. This section of the paper sets out the issues that need to be addressed for Option D to be explained clearly in the chapter on elements and recognition. The paper deals with the following issues and provides TBG and Staff recommendations:
- Terminology
 - Definitions of an asset and a liability, economic phenomena and net financial position
 - Net financial position and capital maintenance
 - Approach to financial performance
 - Definitions of revenue and expenses
 - Recognition criteria for economic phenomena not meeting the definition of an element
 - State of development of conceptual thinking reflected in the Framework

Terminology

27. The IPSASB needs to decide what terms it wishes to be used in referring to transactions and events that do not meet the definition of one of the six defined elements identified in paragraph 24.
28. At the December 2013 meeting the term 'other economic phenomena' was used to denote transactions and events that do not meet the definition of an element. Subsequently it has been

suggested that the term 'other economic phenomena' could be confused with 'other comprehensive income'. Alternative terms are 'other items' or 'other resources' and 'other obligations'. Staff considers that 'other items' is vague. The draft chapter therefore uses the term 'other resources and 'other obligations' because these terms are clearer. The IPSASB is requested to confirm this approach.

Matter(s) for Consideration

1. Do you **agree** with using the terms 'other resources' and 'other obligations' in the chapter on elements and recognition? If not, what term(s) do you favor?

Definitions of an asset and a liability, other resources and other obligations and net financial position

29. The IPSASB needs to decide what terminology to use in referring to the impact of other resources and other obligations on the statement of financial position.
30. In December 2013 the IPSASB discussed the definitions of an asset and a liability. The definitions agreed are:
 - *An asset is a resource that an entity presently controls as a result of a past event*
 - *A liability is a present obligation of an entity for an outflow of resources that results from a past event*
31. These are the definitions that will be used in the chapter on elements. They are consistent with Option D. The definitions of an asset and a liability do not preclude reporting other resources and other obligations in the statement of financial position. Any such items would be specified in standards. Because of this the statement of financial position may report a net position that is not the difference between assets and liabilities (net asset). This amount is the net financial position.
32. The net financial position is the aggregate of an entity's net assets and other resources and other obligations recognized in the statement of financial position at the reporting date. As indicated in paragraph BC53 of the Basis for Conclusions the IPSASB anticipates that for most public sector entities the amounts of net assets and net financial position will not differ, or not differ materially. In these cases, net assets/net financial position will represent the resources available for providing services in future periods and the claims against those resources. However, where other resources and other obligations are recognized in the financial statements, the amounts reported as net assets and net financial position may differ. In these circumstances, the interpretation of net financial position and its relationship to net assets will be determined by reference to the nature of the additional resources and obligations recognized in the financial statements.
33. During the development of the chapter on elements and recognition there have been changing views on whether the Framework should attribute elements to particular financial statements. In order to allow the use of the notion of net financial position Staff hold the view that elements need to be attributed to particular financial statements. The current drafting of the chapter reflects this view.

Matter(s) for Consideration

2. Do you **agree** with the description of, and discussion of, net financial position? If not how would you change it?

Capital Maintenance

The IPSASB needs to decide what, if anything the chapter on elements and recognition should say about concepts of capital maintenance.

34. The IPSASB has given limited consideration to concepts of capital maintenance during the Framework project. There was some examination of capital maintenance in Phase 3: Measurement, but it was not discussed either in the Consultation Paper or Exposure Draft
35. Concepts of capital maintenance are based on the axiom that only revenue in excess of amounts that are need to maintain capital can be regarded as surplus The IASB's current Framework identifies two concepts of capital maintenance:
 - Financial capital maintenance: under this concept a surplus only eventuates if the financial amount of net assets at the end of the reporting period is greater than the financial amount of net assets at the beginning of the period after excluding ownership distributions and contributions; and
 - Physical capital maintenance; under this concept a surplus only eventuates if the operating capacity at the end of the period exceeds the capacity to deliver goods and services at the beginning of the period.
36. Application of concepts of capital maintenance can provide users with further information on the sustainability of an entity by linking the surplus that an entity can present to its financial or operational capacity and can therefore refine the information produced by models of financial performance.
37. The view of the TBG is that neither of those concepts of capital maintenance can be directly applied to the public sector. The concept of physical capital maintenance might be adapted to create a concept of service capacity maintenance for the public sector in the future. Such a concept of capital maintenance might reflect the objective of most public sector entities to deliver services rather than to generate cash flows. However, the TBG concluded that developing appropriate models would require considerable additional work and would delay finalization of the Framework. Therefore the TBG recommends that the Framework does not discuss capital maintenance. The TBG thinks that the IPSASB might signal a longer-term intention to carry out further work on capital maintenance in the future.

Matter(s) for Consideration

3. Do you **agree** that the chapter on elements and recognition should not include a discussion of capital maintenance?
4. Do you **agree** that the IPSASB should signal a longer term intention to consider capital maintenance from a public sector perspective?

Approach to financial performance

38. The IPSASB needs to decide if it agrees with way in which the revised chapter deals with financial performance.
39. The two main models of financial performance are:
 - Changes in net assets in the reporting period:

- Flows relating to the period.
40. The first model of financial performance provides an indication of the extent to which the resources and claims against those resources in the form of liabilities have changed in the year. The second model seeks to associate particular flows with particular reporting periods. The second model is linked to the notion of inter-period equity and also facilitates an assessment of the sustainability of an entity's operations, because it controls for flows that finance activities over more than one reporting period.
41. The TBG has proposed discussing these two models of financial performance to reflect the importance of both notions. Paragraphs 4.7-4.9 of Section 4 relate surplus to an entity's operational and funding model. While the Framework does not define "revenues designated to fund operations during the reporting period", nor "expenses incurred as part of its operating model" as separate elements it indicates that IPSASs may identify, and require the disclosure of such classifications of items to provide information to meet information objectives.

Matter(s) for Consideration

5. Do you **agree** with paragraphs 4.7-4.9 on financial performance? If not, how would you change these paragraphs?

Definitions of revenue and expenses

42. CF-ED2 proposed definitions of revenue and expenses that were (i) based on increases and decreases in net assets other than ownership contributions and ownership distributions, but also (ii) articulated with DIs and DOs. The decision not to define DIs and DOs means that new definitions of revenue and expenses must be developed.
43. There are two basic approaches to these definitions derived from the notions of financial performance discussed above:
- (a) Define revenue and expenses by reference to movements in net financial position; or
 - (b) Define revenue and expenses by reference to movements in net assets with an acknowledgement that definitions of revenue and expenses neither preclude nor require items to be reported in surplus/deficit
44. The TBG considered it more transparent to adopt the first approach. Therefore section 4 provides the following definitions of revenue and expenses:
- Revenue is:
 - (a) Increases in assets and other resources and reductions in liabilities during the current reporting period that increase the net financial position, other than ownership contributions; and
 - (b) Reductions in amounts recognized as other obligations in previous reporting periods.
 - Expense is:
 - (a) Increases in liabilities and other obligations and reductions in assets during the current reporting period that decrease the net financial position, other than ownership distributions; and
 - (b) Reductions in amounts recognized as other resources in previous reporting periods.

Matter(s) for Consideration

6. Do you **agree** with:
- The approach to definitions of revenue and expenses? If not what are the alternative approaches?
 - The definitions of revenue and expense? If not provide alternative wording.

Recognition and 'other resources' and 'other obligations'

45. The IPSASB needs to agree how the recognition criteria for elements relate to other resources and other obligations.
46. The TBG and Staff view is that because other resources and other obligations are not defined elements the discussion of existence uncertainty is not possible. However, measurement uncertainty can and should be assessed. There must be an appropriate measurement basis and an evaluation of whether the measurement of the item meets the QCs and that that the measurement must be sufficiently relevant and faithfully representative in order for 'other resources' or 'other obligations' to be recognized in the financial statements.

Matter(s) for Consideration

7. Do you **agree** with the above analysis of how other resources and other obligations relate to recognition criteria? If not, how do other economic phenomena relate to recognition criteria?

State of development of conceptual thinking reflected in Framework

47. The TBG considers that the Conceptual Framework should acknowledge that it does not capture all information necessary to meet the objectives of financial reporting. The Conceptual Framework will therefore not be the final word on these issues. Paragraph BC43 therefore acknowledges that the concepts applicable to financial reporting and the notions of financial performance and financial position to be reflected in financial statements continue to evolve and, as noted in the Preface, this Conceptual Framework is to be viewed as a living document. Consequently, the identification of elements of financial statements as identified in this document may be developed further in the future.
48. In the view of the TBG the IPSASB should also make a statement that the Conceptual Framework is a living document that will respond to developments in conceptual thinking. The Coordinator has already indicated that he will raise the issue of the approach to reviewing the Framework later this year.

Matter(s) for Consideration

8. Do you **agree** that the Framework should include:
- An acknowledgement that concepts will continue to develop; and
 - A statement that the Framework is a 'living' document.

CONCEPTUAL FRAMEWORK ISSUES PAPER: DRAFT CHAPTER 5**Marked-Up Draft: Chapter 5: “*Elements and Recognition in Financial Statements*”**

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

Introduction

1. Agenda Item 4A.3 is a marked-up draft of the proposed Chapter 5 *Elements and Recognition in Financial Statements* of the Conceptual Framework. The Chapter is based on Exposure Draft 2 (CF–ED2), *Elements and Recognition in Financial Statements* issued in November 2012 for comment by April 30, 2013. (Agenda Item 4A.3 includes an attachment which identifies the Alternative Views and comparison with IASB and GFS approaches which were included in CF–ED2. These will not be included in the final Chapter. They are included here in the draft to allow Members to refer to them as appropriate).
2. The draft Chapter 5 includes amendments to the text of CF–ED2 (Sections 1, 4, 5 and 7 and related BC paragraphs) to reflect the revised approach to identification of the elements (described as Option D) tentatively agreed at the IPSASB’s December 2013 meeting. Agenda Item 4A.1 provides background to these amendments, including the issues and possible approaches to their resolution considered by staff and the Task Based Group (TBG).
3. At meetings in June, September and December 2013, the IPSASB considered and tentatively agreed a number of amendments to the sections of CF–ED2 dealing with assets, liabilities, ownership contributions, ownership distributions and recognition (Sections, 2, 3, 6 and 7) and the related basis for conclusion (BC). This paper outlines proposed amendments to those sections that have not yet been considered by the IPSASB. The broad nature of those proposed amendments are outlined below in the sequence in which they appear in the draft Chapter. For the most part they are amendments proposed by the TBG and/or staff in response to directions of the IPSASB at its September and December 2013 meetings. In some 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. A number of these proposed amendments were included in agenda materials provided for review at the December 2013 meeting but, because of time constraints, were not considered at that meeting.
4. Agenda Item 4A.3 identifies by mark-up all amendments to CF–ED2, including those previously reviewed and agreed by the IPSASB at its meetings in 2013. They are included to enable members to identify the cumulative changes to CF–ED2. Boxed text in Agenda Item 4A.3 identifies those amendments that have been agreed previously by the IPSASB and those proposed by the TBG and staff but not yet considered by the IPSASB. In some cases, staff proposals for alternative wording are also identified in the boxed text. Extracts of the minutes of the September and December 2013 meetings identifying the decisions and directions of the IPSASB at those meetings are included at Agenda Item 4A.4 and 4A.5 for the information of Members.
5. A clean copy of the draft Chapter 5 is also attached as Agenda Item 4A.3b. This is intended to help with your review of paragraphs that include more complex revisions. However, it is proposed that at

the meeting Members will review the text and related BC of the marked-up draft Chapter 5 (Agenda Item 4A.3).

6. The background to the more substantial amendments to each section of the draft Chapter 5 and related BC are identified below. While the following outlines the nature of proposed amendments to the text and its related BC on a section by section basis, it is proposed that the IPSASB will initially review the text of the proposed Chapter 5 and then move on to review the BC, rather than switching backwards and forwards between text and BC on a section by section basis. This is because, in many cases, changes to the text will have a pervasive influence over the explanation in a number of sections of the BC, and an attempt to review text and all related BC paragraphs is unlikely to be an efficient or effective means to progress.

Section 1: Introduction

7. Section 1 of the draft Chapter 5 and its related BC have been revised to reflect decisions made by the IPSASB at meetings in September and December 2013. In particular, to reflect IPSASB decisions at the December 2013 meeting that the approach known as “Option D” is to be adopted for identification of the elements of the financial statements. (Option D is explained in full in Agenda Item 4A.1.) In broad terms, adoption of Option D means that in Section 1 has been revised such that:
 - (a) Deferred inflows and deferred outflows are not identified as elements – see amendments to paragraphs 1.2, 1.5, 1.7; and
 - (b) Text has been added (paragraph 1.4) to acknowledge that IPSASs may require or allow some resources and obligations that do not satisfy the definition of an element to be recognized in the financial statements when this is necessary to achieve the objectives of financial reporting.
8. As noted in Agenda Item 4A.1, the terms “other resources” and “other obligations” (rather than “items” or “economic phenomena”) are considered to most clearly capture the intent of Option D with respect to the transactions and events that do not meet the definition of an element but may be recognized in the financial statements. Their use also assists in providing some structure to the text and potential reference points for readers because “resources” and “present obligations” were described in CF–ED2 and have been further clarified in the draft Chapter 5. These terms have been used throughout the draft Chapter 5.
9. Staff proposes that paragraph 1.9 be deleted to reflect revisions to the explanation of recognition consistent with IPSASB’s discussion of this matter at the December 2013 meeting. The proposed revisions to the explanation of recognition are discussed at Section 7 below. (Staff proposes that consideration of whether paragraph 1.9 should be deleted be revisited after discussion of Section 7 which deals with recognition and proposed revisions thereto.)
10. Other amendments to this Section have been made to reflect the movement from exposure draft to final Chapter of the Framework and to reduce some explanation considered unnecessary at paragraph 1.7.

The Basis for Conclusions

11. Amendments to BC paragraphs BC2, BC3, BC4, and BC39 to BC43 outline the IPSASB’s deliberations on whether to identify deferred inflows and deferred outflows as elements, whether to specify the financial statements in which each element is to be recognized, and alternate

approaches to definitions of the elements. However, other BC paragraphs also touch on the background to these and other matters addressed in this Section. These interrelationships will be drawn out as the IPSASB reviews the BC following its review the text of the Chapter.

Matter(s) for Consideration

1. The IPSASB is asked to **note** the staff proposed revisions to Section 1 of the draft Chapter 5 and related paragraphs of the BC (at Agenda item 4A.3) and to **confirm** whether it agrees with staff views.

Section 2: Definition of an asset and explanation of a resource

Refinements to the definition of an asset and explanation of a resource

12. At its September and December meetings in 2013, the IPSASB reviewed and agreed proposed amendments to the definition of an asset and the explanation of a resource. These amendments responded to concerns of respondents, including that there was overlap and a blurring of the difference between a resource and an asset and to enhance drafting. The revised definition of an asset agreed in December 2013 is:

"2.1 An asset is a resource that an entity presently controls as a result of a past event."

13. Amendments to the remaining paragraphs of this Section of the proposed Chapter (paragraphs 2.2 to 2.8) and related BC paragraphs (BC5-BC21) were also agreed at the September 2013 meeting. However, staff also proposes that:
 - (a) Reference to "benefits" in paragraph 2.2 be replaced by "service potential and economic benefits" to avoid any potential misinterpretation or misunderstanding about the meaning of benefits and what it may encompass. For consistency, similar amendments have also been processed elsewhere in the draft Chapter as appropriate; and
 - (b) The first sentence of paragraph 2.3 be deleted. This is because the nature of a resource is now the primary focus of paragraph 2.2. The amendments to paragraph 2.2 have made retention of the first sentence in para 2.3 unnecessary and repetitious;
 - (c) The subheading "An Entity Presently Controls" has been revised here and in the BC to read "An Entity Controls". While the definition of an asset includes the phrase "presently controls", the text of this Section and the BC focusses on explaining control; and
 - (d) The BC paragraphs have been further refined to ensure that the characteristics of an asset and a resource referred to in the BC are consistent with the revised definition and description of those items in paragraph 2.1 and 2.2.
14. Revisions to BC7 were agreed at the September 2013 meeting. At that meeting, staff noted the concerns of one TBG member that the revisions to the paragraph 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. With hindsight, staff is of the view that there is a case that BC7 could be refined to mitigate this concern, and ensure that the sentence is not read as pre-empting the role of the recognition criteria. Consequently, staff proposes that the second sentence of BC7 use the phrase "satisfy the definition of an asset" rather than "give rise to assets", and that an additional sentence be added to acknowledge that additional guidance may be provided at standards level. Paragraph BC7 would then read

“Unconditional rights 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 unconditional rights that represent service potential or economic benefits that are controlled by the entity as a result of a past event satisfy the definition of an asset. Whether such assets qualify for recognition will be dependent on whether recognition criteria have been satisfied. Additional guidance on particular circumstances where unconditional rights give rise to an asset may be provided at standards-level.”

The proposed revised paragraph together with some background to the proposed amendments is identified in boxed text that follows BC7 in Agenda Item 4A.3.

Matter(s) for Consideration

2. The IPSASB is asked to **note** the proposed revisions to paragraphs 2.2 and 2.3, the subheading dealing with control and related paragraphs of the BC of the draft Chapter 5 (at Agenda Item 4A.3), and to **confirm** whether it agrees with staff views.
- The IPSASB is also requested to **confirm** whether it agrees with staff proposals for revision of paragraph BC7.

Section 3: Definition of a liability and explanation of present obligation

Refinements to the definition of a liability and explanation of a present obligation

15. At its September and December 2013 meetings, 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 text of the proposed Chapter 5 attached at Agenda Item 4A. The revised definition of a liability in paragraph 3.1 is:

“A liability is a present obligation of an entity for an outflow of resources that results from a past event.”

16. 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” rather than the long form “service potential or economic benefits” when referring to features of a liability—that is, use the terms included 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.

Terminology - Other non-binding obligations

17. 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 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.

18. More generally, staff found the term “other binding obligation” awkward to use from a drafting perspective. Staff is also 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 a number of respondents to CF–ED2 used the term non-legally binding obligations in their submissions, one respondent (009) suggested that the term “non-legally binding obligation” may be used as an alternative to “other binding obligation” and one respondent (039) proposed that the term not legally binding obligations be used to avoid any suggestion of illegality.
19. On reflection, staff is of the view that a term such as “non-legally binding obligation” may be a clearer and more user friendly term than “other binding obligation”. This view has been reinforced with the redrafting of sections of CF–ED2 to adopt Option D. Option D uses the terms “other resources” and “other obligations” to identify items that do not satisfy the definition of an element but may be recognized in the financial statements in accordance with an IPSAS. Using the term “non-legally binding obligations” will remove concerns that the distinction between “other binding obligations” in the context of liabilities and “other obligations” in the context of Option D may be blurred.

Political coercion

20. At its September 2013 meeting, the IPSASB considered a draft of paragraph 3.8 of the draft Chapter 5 that used the phrase: “Enforceability does not include economic coercion or political coercion...” Some Members noted that, while they supported the intention 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. In an attempt to draw out the underlying intent of the IPSASB, 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.

Little or no realistic alternative to avoid

21. 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 4A.3 also uses this phrase in its description of a present obligation as follows:

“A present obligation is a legal or other binding requirement, which an entity has little or no realistic alternative to avoid.”
22. 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 intention of the IPSASB and consequently the IPSASB agreed that the phrase “...little or no realistic alternative to avoid” was to be retained.

23. Staff have included in boxed text before paragraph BC31 for Members’ review a proposed additional paragraph intended to explain the background to the IPSASB’s decision on this matter. That paragraph explains that the IPSASB noted the comments from respondents and considered, but decided against, removal of the phrase “little or no” from the description of a present obligation.

Matter(s) for Consideration

3. The IPSASB is asked to **note** the proposed revisions to the wording of the definition of a liability and proposed amendments to other paragraphs of Section 3 and its related BC of the draft Chapter 5 (at Agenda Item 4A.3), and to **confirm** whether it agrees with those proposed amendments.

Section 4. Revenue and Expenses

24. Section 4 of the proposed Chapter (paragraphs 4.1 to 4.9) and its related BC (paragraphs BC39 to BC 47) have been revised to reflect the adoption of Option D to identification of the elements of financial statements. Consequently, deferred inflows and deferred outflows have been removed from the definition of revenue and expenses in paragraphs 4.1 and 4.2. As outlined in Agenda Item 4A.2, the definitions of revenue and expenses have been reconstructed to, in broad terms, reflect that:
- (a) The determination of revenue and expenses will encompass the impact of resources and obligations that do not satisfy the definition of an element (other resources and other obligations) but are recognized in the financial statements in accordance with Option D; and
 - (b) Revenues and expenses will arise from increases or decreases in net financial position (rather than net assets) that are not the result of ownership contributions or ownership distributions.
25. Paragraphs 4.8 and 4.9 have been added to outline notions of financial performance that may be presented in the statement of financial performance and the interpretation of the resulting surplus or deficit. Paragraph 4.9 also acknowledges the relationship between the notion of financial performance generated by application of the definitions of revenue and expenses and user information needs as outlined in Chapter 2. The link between Chapter 2 and the elements and other resources and other obligations as identified in this Chapter is further developed in Section 5 of this Chapter.

Increases and decreases in net assets or net financial position

26. Paragraph 4.5 of CF–ED2 explained that 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. At its June and September 2013 meetings the IPSASB acknowledged that, literally, this meant that all changes in the value of assets and liabilities

would be recognized as revenue or expense, and this seemed to exclude the possibility that value adjustments may be taken directly to equity. It was agreed that this was not intended and the explanation in paragraph 4.5 should be revisited once the IPSASB had agreed its approach to identification of the elements of financial statements. This paragraph has now been revised to remove the inference that all value changes give rise to revenue and expenses and to note that measurement of the elements is dealt with in Chapter 6 of the Conceptual Framework.

Terminology - singular or plural

27. Staff notes that the definitions refer to revenue (singular) and expenses (plural). This terminology is also used in IPSAS 1 (and other IPSASs) and in the 1989 IASB Conceptual Framework. While not causing any specific problem in the definition or explanation of these elements, staff is of the view that in the interests of consistency, there is a case for representation of both revenue(s) and expense(s) as either singular or plural. As the IPSASB considers this matter it is probably worth noting that the definitions of the elements:
- (a) Asset and liability are singular; and
 - (b) Ownership contributions and ownership distributions are plural.
28. Subject to IPSASB agreement staff proposes that all the elements be defined in the singular case.

The basis for conclusions

29. Paragraphs BC39 to BC42 have been updated to include a summary of the views of constituents to CF-ED2, to note that the IPSASB has responded to those views and to outline the nature of that response.
30. Paragraph BC43 explains that the IPSASB is of the view that the Conceptual Framework is a living document and the concepts reflected in it, including the identification of the elements, may be revisited and updated as the notions of financial performance and financial position evolve over time and in light of the experience of preparers, users and standard setters. Staff is of the view that the notion that the Conceptual Framework is a living document reflects, at least in part, the sense of the IPSASB's discussion that led to the decision to adopt of Option D to the identification of the elements—it also reflects the discussion of other aspects of the Conceptual Framework including, for example, the scope of financial reporting in Chapters 1 and 2. Paragraph BC43 explains that this notion of the Conceptual Framework as a living document is identified in the Preface to the Conceptual Framework. This is not currently the case—the Preface does not refer to the Conceptual Framework as a living document. However, staff is of the view that, if Option D to the identification of the elements is adopted, it would be appropriate to include such an observation in the Preface.

Matter(s) for Consideration

4. The IPSASB is asked to **note** the proposed revisions to the definition of revenue and expenses and other paragraphs of Section 4 and its related BC of the draft Chapter 5 (at Agenda Item 4A.3), and to **confirm** whether it agrees with those proposed amendments.

Section 5: Other Resources and Other Obligations

31. Section 5 and its related BC (paragraphs BC48 to BC55) have been revised to reflect adoption of Option D to identification of the elements. Therefore, the text outlines the circumstances in which

“other resources” and “other obligations” may be recognized. Paragraphs that define deferred inflows and deferred outflows and identify and explain their characteristics have been deleted.

32. New paragraphs 5.1 and 5.2 explain that IPSASs may require or allow resources or obligations that do not satisfy the definition of an element (referred to as other resources or other obligations) to be recognized in the financial statements when considered necessary to achieve the objectives of financial reporting. Paragraph 5.1 notes the objectives of financial reporting and briefly summarizes users information needs as identified in Chapter 2 of the Conceptual Framework. Paragraph 5.2 explains that decisions about whether or not to require or allow the recognition of other resources will be made in the interests of responding to, and will be governed by, those objectives and information needs. Paragraph 5.2 also establishes that, in the interests of transparency, these other resources and other obligations will be identified as separate classes in the financial statements.

The Basis for Conclusions

33. The BC to Section 5 outlines alternative approaches to the definition of the elements and presentation of information about financial performance considered by the IPSASB. It has been updated to include those approaches considered by the IPSASB at its meetings in September and December 2013, including those outlined in Agenda Item 4A.2.

Matter(s) for Consideration

5. The IPSASB is asked to **note** the proposed revisions to Section 5 of the draft Chapter 5 and its related BC (at Agenda Item 4A.3), and to **confirm** whether it agrees with those proposed amendments.

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

Net Assets and Net Financial Position

34. Amendments to reflect Option D to identification of the elements have been made to paragraphs 6.1 and 6.2 and related BC paragraphs BC56, BC57, BC58 and BC59.

Ownership contributions and ownership distributions

35. A final sentence has been added to paragraph 6.2 to acknowledge that ownership contributions and ownership distributions are not elements of the Statement of Financial Position. This amendment was agreed by the IPSASB at its meeting in September 2013. However, on reflection, staff is not convinced that it fits well, or is necessary, in this paragraph – this observation is already included in paragraph 1.2. Staff proposes that it be deleted from paragraph 6.2.
36. Amendments to the definition and explanation of ownership contributions and ownership distributions at paragraphs 6.3, 6.4 and 6.5 have been made to clarify that ownership contributions and ownership distributions flow from, or to, the external parties *in their capacity as owners*. These amendments were agreed by the IPSASB at its meeting in December 2013.

Matter(s) for Consideration

6. The IPSASB is asked to **note** the proposed revisions to Section 6 of the draft Chapter 5 and the related BC (at Agenda item 4A.3) and **confirm** whether it agrees with those revisions.

Recognition

37. At its June and September 2013 meetings, the IPSASB noted concerns raised by respondents to CF–ED2 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 4A.3 (see paragraphs 7.4, final sentence of BC64, and BC68).

Existence Uncertainty

38. At the December 2013 meeting the IPSASB noted staff concerns that the distinction between determining whether the definition of an element is satisfied, and applying the recognition criteria of “existence uncertainty” as a “distinct stage in the accounting process”, was not made clearly enough in CF–ED2. Staff also noted that the discussion of existence uncertainty explained that uncertainty about the flow of service potential or economic benefits to or from the entity was to be reflected in measurement. However, it did not provide guidance on how standard setters and others are to respond to “existence uncertainty” in respect of the other characteristics of an element – that is, does such uncertainty also feed into measurement of the element or does it mean that, depending on assessments of the nature and extent of that uncertainty, the element should not be recognized.
39. Staff proposed that to better reflect the intent and role of the recognition criteria as explained in the text and BC of CF–ED2, the sub-section “Existence uncertainty” should be retitled and its explanation refined to make clear that it was limited to dealing with uncertainty about the flows of service potential or economic benefits to or from the entity.
40. As noted in the minutes, at its meeting in December 2013 the IPSASB considered but decided not to adopt this staff proposal, and confirmed that the recognition criteria “existence uncertainty” related to uncertainty about all of the characteristics of an element. However, the IPSASB also agreed that the discussion of “existence uncertainty” should be refined. Staff have included in the draft Chapter 5, in mark-up or boxed text, proposals to give effect to the directions of the IPSASB. The rationale underpinning these revisions are outlined below. These are outlined below.

Satisfaction of the definition of an element and recognition as a distinct phase in the accounting process

41. The text of CF–ED 2 and the draft Chapter 5 currently reflect that (i) recognition is a distinct stage in the process which occurs after an item satisfies the definition of an element, and (ii) the definitions of the elements do not include any recognition criteria. For example:

“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...” (Paragraph 7.1)

42. The current explanation of the operation of existence uncertainty reflects that, for example:
- (a) An item that has been assessed to satisfy the definition of an asset (because the past event has occurred and the entity presently controls a resource);
 - (b) May fail the recognition test because of some uncertainty about the past event or control that is only considered at the recognition stage—that is, after the item has been assessed to satisfy the definition.

43. Staff is of the view that existence uncertainty will need to have been considered in determining whether the definition of an element has been satisfied—it is then awkward to see the application of the recognition criteria “existence uncertainty” as a *distinct stage in the accounting process* quite separate from consideration of whether the definition of an element has been satisfied. This view was reinforced by, for example, paragraph BC53 of CF–ED2 (paragraph BC 61 of the draft Chapter 5 at agenda item 4A.3) which explained:

“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 asset.”

44. Staff is of the view that paragraph 7.2 and the first sentence of 7.3 in the subsection “existence uncertainty” may be better placed as a separate section following the definitions of the elements. This is because it deals broadly with circumstances which may give rise to an element and the appropriate response to that uncertainty. However, staff appreciates that this type of approach has been previously considered by, but has not persuaded, the Board. Consequently, to attempt to clarify the relationship between the recognition criteria and satisfaction of the definition of an element, staff proposes deletion of the statement that “*recognition is a distinct stage of the accounting process*” in some paragraphs and its replacement in other paragraphs with an acknowledgement that matters relevant to an assessment of existence uncertainty will have been considered in determining whether the item satisfies the definition of an element (see paragraphs 1.9, BC60, BC61, BC 66 and boxed text following paragraphs 7.1 and 7.3). Staff has also built into these paragraphs an acknowledgement that recognition criteria will also apply to the other resources and other obligations recognized consistent with the Option D approach to identification of the elements.

Guidance on the consequences of not satisfying the recognition criteria of existence uncertainty

45. Paragraph 7.3 of CF–ED2 and the draft Chapter 5 explain that uncertainty about the flow of service potential or economic benefits to or from the entity is reflected in measurement. Staff is of the view that this Chapter of the Conceptual Framework should also make clear the IPSASB’s view on whether “existence uncertainty” in respect of the other characteristics of an element is also to be reflected in measurement of the element or, depending on assessments of the nature and extent of that uncertainty, result in non-recognition of the element.
46. Staff’s proposed amendments to paragraphs 7.1 and 7.3 reflect that failure to satisfy the recognition criteria of “existence uncertainty” will mean that the element will not be recognized in the financial statements. However, staff acknowledges that it may be that other consequences may be intended by the IPSASB, particularly given that the recognition criteria are to be applied to items that meet the definition of an element, and this will need to be clarified at the forthcoming meeting.

Explanation of adoption of thresholds for recognition purposes.

Paragraph BC64 outlines the IPSASB’s concerns with the adoption of thresholds for recognition purposes. It explains that in light of these concerns the IPSASB concluded that, on balance, an approach that is based on an assessment of all available evidence is more appropriate.

47. Staff agrees with the concerns identified in this paragraph and that an approach based on an assessment of all available evidence as explained in the BC is a more appropriate response to “existence uncertainty”. However, staff is of the view that it could be argued that many of the

observations about shortcomings of the threshold approach will also apply to other “no threshold” approaches. This is because assessments about what circumstances or how much uncertainty justifies a decision to recognise (or not recognise) may be made on a different basis by different preparers.

48. Staff is of the view that there is a case for some refinements to be made to paragraph BC64 to, acknowledge that some reservations about the threshold approach may also apply to other approaches to recognition, but an approach based on an assessment of all available evidence is more likely to satisfy the QCs. Paragraph BC64 has been marked up to identify the amendments proposed by staff. Boxed text preceding the paragraph briefly explains these changes.

Matter(s) for Consideration

7. The IPSASB is asked to **note** the staff proposed revisions to Section 7 of the draft Chapter 5 and its related BC (at Agenda item 4A.3) and **confirm** whether it agrees with those proposals.

Next Meeting

49. 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 and approval at the next meeting.

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

THIS DRAFT FOR IPSASB REVIEW MARCH 2014

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Staff Note: Formatting, 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 ~~those~~ definitions. It also deals with recognition.

Elements and their Importance

Staff comment: Amendments to paragraph 1.2 to reflect that ownership contributions and ownership distributions are not elements of the statement of financial position were agreed at the IPSASB's meeting in September 2013. Further amendments to paragraph 1.2 and the addition of paragraph 1.4 reflect the decision to adopt Option D to identification of the elements.

- 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 ~~and~~ liabilities, ~~deferred inflows, 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 is~~ are addressed in Phase 4 Chapter 7 Presentation in General Purpose Financial Reports of this Conceptual Framework.

- ~~1.3~~1.4 In some circumstances, to ensure that the financial statements provide information that is useful for a meaningful assessment of the financial performance and financial position of an entity, recognition of economic phenomena that are not captured by the elements as defined in this Chapter may be necessary. Consequently, the identification of the elements in this Chapter does not preclude IPSASs from requiring or allowing the recognition of resources or obligations that do not satisfy the

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.

definition of an element identified in this Chapter (hereafter referred to as “other resources” or “other obligations”) when necessary to better achieve the objectives of financial reporting.

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

Staff Comment: Paragraphs 1.5 and 1.7 have been revised to reflect that DI and DO are not identified as elements and other consequences of Option D. As noted in the covering issues paper, questions of terminology are to be resolved at this meeting.

~~1.4~~1.5 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)~~(e) Ownership contributions; and
- ~~(h)~~(f) Ownership distributions.

~~1.5~~1.6 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~~1.7 Net financial position is the net assets aggregate of an entity's ~~assets~~ and the net amount of other resources less other obligations recognized in the statement of financial position ~~deferred outflows less an entity's liabilities and deferred inflows~~ at the reporting date. ~~It and~~ can be represented by:

$$\text{Assets} - \text{Liabilities} + (\text{Other resources} - \text{Other Obligations}) = \text{Net Financial Position}$$

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

~~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.

~~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.~~

Staff Comment: Staff has deleted “old” paragraph 1.9 given that existence uncertainty will be relevant in determining whether an item satisfies the definition of an element. This deletion is subject to the Board decision on the explanation of recognition at this meeting.

~~1.10 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 the 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. This amendment was agreed at the IPSASB meeting in September 2013.

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~~ as a result of a past event.

Staff Comment: The above construction of paragraph 2.1 was discussed and agreed at the September and December 2013 meetings.

Amendments to paragraphs 2.2 and 2.4 below were agreed at the September 2013 meeting. The first sentence of paragraph 2.3 below has been deleted in this draft—because this is the primary focus of paragraph 2.2 as revised, and some minor editorial amendments have been processed.

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 ~~service potential or economic benefits~~ 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 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:

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

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

- (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

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.

The section heading has been revised to reflect that the section deals with control.

~~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.

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 ~~is~~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.

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 ~~results~~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 above were agreed at IPSASB meetings in September and December 2013. Subject to IPSASB agreement at this (March 2014) meeting, Staff proposes that the term “other binding obligations” be replaced by “non-legally binding obligations” throughout the Chapter.

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 to this point as a consequence of the identification and clarification of the characteristics of a present obligation and a liability at IPSASB meetings in September and December 2013. 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.

Past Event

- ~~3.3.3.4~~ 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 binding 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 law⁵. 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

⁵ References to obligations enforceable in law encompass legal obligations and binding obligations subject alternative processes with equivalent effect.

having to meet further conditions—~~that is to say or~~ 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 ~~concluding that the non-recognition of an~~ obligations ~~does not that otherwise~~, meet the definition of a liability in this Framework ~~and therefore cannot be recognized~~. 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 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 that gives rise to ~~a liability~~esy ~~has~~ 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 ~~the~~ budget (which may be two distinct points); and
- (d) ~~The b~~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 ~~an 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 ~~resources~~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 ~~has little or no realistic alternative to 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 ~~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 ~~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 ~~resources~~ 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 paragraph has been relocated to follow para 3.2 above.

4. Revenue and Expenses

Staff comment: The definition and explanation of revenue and expenses in the following paragraphs have been revised to reflect the decision to adopt Option D to identification of elements. The terms “net financial position”, “other resources” and “other obligations” have been used in the definition of revenue and expenses in this draft. However, this terminology is still subject to agreement by the IPSASB. This section will be revisited following IPSASB discussion and directions at this meeting.

Definitions

4.1 Revenue is:

- (a) ~~Inflows~~ Increases in assets and other resources and reductions in liabilities during the current reporting period, ~~that which~~ increase the net financial position ~~assets~~ of an entity, other than:
- ~~(i) Ownership contributions; and~~
 - ~~(a)(b)~~ Reductions in amounts recognized as other obligations in previous reporting periods.
 - ~~(ii) Increases in deferred inflows; and~~
 - ~~(d) (b) Inflows during the current reporting period that result from decreases in deferred inflows.~~

4.2 Expenses are:

- (a) ~~Outflows~~ Increases in liabilities and other obligations and reductions in assets during the current reporting period ~~that which~~ decrease the net financial position ~~assets~~ of an entity, other than
- ~~(i) Ownership distributions; and~~
 - (b) Reductions in amounts recognized as other resources in previous periods ~~(ii) Increases in deferred outflows; and~~
 - ~~(c) (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 Financial Position ~~Assets~~

4.3 Revenues and expenses provide users with information about changes in an entity's resources and obligations during a period from service delivery and other activities, other than those changes that arise as a consequence of contributions from or distributions to owners. Such information informs assessments of the net financial position of the entity and the reasons for changes therein over the reporting period. As noted in paragraph 1.4, this Conceptual Framework acknowledges that all economic phenomena that should be reported in GPFs consistent with the objectives of financial reporting may not be captured by changes in assets and liabilities as defined. Therefore, revenues and expenses are defined to encompass changes in assets and liabilities and other resources and other obligations that contribute to a change in the net financial position of the entity over the

reporting period and are recognized in the statement of financial position consistent with the requirements of IPSASs.

- 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 Chapter 6 Measurement of Assets and Liabilities in Financial Statements of the Conceptual Framework outlines the measurement bases that may be adopted for financial reporting purposes. It explains that IPSASs will include requirements and provide guidance on the bases that may be adopted for the measurement of revenues and expenses arising from particular transactions or other events. 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 the first sentence of paragraph 4.5 reflected that all changes in the value of assets and liabilities would be included as revenue and/or expenses, and agreed that this explanation should be revisited. Paragraph 4.5 has been amended to remove that sentence, delete reference to deferred inflows and deferred outflows and to link to Chapter 6 which deals with measurement of the elements.

- 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 sStatement of fFinancial pPerformance. The difference between revenue and expenses is the entity's surplus or deficit for the period, which is the primary indicator of financial performance.
- 4.8 Public sector entities typically have an operating and funding model (sometimes called a business model). The net result of those revenues designated to fund operations during the reporting period, and those expenses incurred as part of its operating model, will be represented either as a surplus or deficit. The net result provides information on the financial performance of the operating and funding model. If a surplus, this measure provides an indicator of the ability of the entity to reduce demands on resources from resource providers, increase services provided to recipients, or to increase the financial resilience of the entity by, for example, reducing debt, or any combination thereof. If a deficit, this measure provides an indicator of the need to increase demands on resources from resource providers, reduce services provided to service recipients, or to reduce the financial resilience of the entity by, for example, increasing debt, or any combination thereof.
- 4.9 This Conceptual Framework does not define "revenues designated to fund operations during the reporting period", nor "expenses incurred as part of its operating model" as separate elements. IPSAS may however make such classifications of items to respond to the information needs of service recipients and resource providers as identified in Chapter 2 of this Conceptual Framework.

5. ~~Deferred Inflows and Deferred Outflows~~ Other Resources and Obligations

Staff comment: The paragraphs dealing with the definition and explanation of deferred inflows and deferred outflows have been deleted to reflect the decision to adopt Option D to identification of the elements. Paragraphs 5.1 and 5.2 explain that IPSASs may require or allow resources or obligations that do not satisfy the definition of an element to be recognized when considered necessary to achieve the objectives of financial reporting.

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 stipulation 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.~~

5.1 Chapter 2 of the Conceptual Framework identifies the objectives of financial reporting as the provision of information useful for accountability and decision making purposes, outlines the information users will need for those purposes and explains the role of financial statements and other GPFRs in providing such information. Chapter 2 notes that for accountability and decision making purposes users will need information about such matters as:

- (a) The performance of the entity during the reporting period in meeting its service delivery and financial objectives, managing the resources it is responsible for, and complying with relevant budgetary and other authority regulating the raising and use of resources; and
- (b) The liquidity and solvency of the entity and the sustainability of the entity's service delivery and other operations over the long term, and changes therein as a result of the activities of

the entity during the reporting period including, for example, changes to its financial and operating capacity.

5.2 In some cases, in developing or revising an IPSAS, the IPSASB may determine that to achieve the objectives of financial reporting a resource or obligation that does not satisfy the definition of an element should be presented in the financial statements. In these cases, the IPSAS may require or allow these resources or obligations to be recognized as “other resources” or “other obligations”, being classes of items additional to the elements.

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

Net Assets and Net Financial Position

Staff comment: The amendments to paragraphs 6.1 and 6.2 below have been made to reflect adoption of Option D to identification of the elements, and to acknowledge that Ownership Contribution and Ownership Distributions are not elements of the statement of 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 other resources and deducting other obligations recognized in the statement of financial position~~deferred outflows~~. As noted in paragraph 1.8, nNeither net assets nor net financial position are elements.
- 6.2 All items that meet the definition of assets and, liabilities, ~~deferred inflows, deferred outflows, ownership contributions, and ownership distributions~~, and satisfy the recognition criteria set out in Section 7 of this Chapter are reported on the ~~S~~statement of ~~F~~financial ~~P~~position. Except where an IPSAS requires or allows an item that does not satisfy the definition of an asset or liability to be recognized in the statement of financial position as an other resource or an other obligation, net assets and net financial position will both be determined as the difference between assets and liabilities. Net assets and net financial position can be a positive or negative residual amount. Ownership contributions and ownership distributions are reported in other financial statements included in GPFRs.

Ownership Contributions and Ownership Distributions

Definitions

Staff comment: The amendments to the definition of ownership contributions and ownership distributions in paragraph 6.3 and 6.4 were agreed at the December 2013 meeting, and the amendments to the first sentence of paragraph 6.5 have been included as a consequence.

The addition of the final sentence of 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.

- 6.3 Ownership contributions are inflows of resources to an entity, contributed by external parties in their capacity as owners, 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 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, including those inflows that initially establish the ownership interest, and outflows of resources to owners, in their ~~role capacity~~ as owners, from revenue and, 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.
- 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

Staff comment: At its December 2013 meeting the IPSASB directed that “old” paragraph 7.2 be relocated to follow the paragraph dealing with measurement uncertainty. The IPSASB also agreed that the discussion of existence uncertainty needed some revision to clarify the relationship of existence uncertainty to satisfaction of the definitions of an element.

Paragraph 7.2 has been relocated as directed. Boxed text following paragraphs 7.1 and 7.3 identifies staff proposed revisions to those paragraphs, including revisions intended to embrace consequences of adoption of Option D on the identification of elements.

The amendments to paragraph 7.4 were agreed at the September 2013 meeting the IPSASB.

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.

Staff propose that paragraph 7.1 be split into two and revised as outlined below

“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 of, and constraints on, information included in GPFs. All items that satisfy the definition of an element and the recognition criteria are recognized in the financial statements. -In some circumstances, an IPSAS may also specify that, to achieve the objectives of financial reporting, a resource or obligation that does not meet the definition of an element is to be recognized in the financial statements provided it can be measured in a way that meets the QCs and constraints. ~~Recognition is a distinct stage in the accounting process. Therefore the definitions of the elements do not include recognition criteria.~~

7.2 Recognition involves an assessment of ~~existence~~ uncertainty related to the existence and measurement uncertainty of the element or other resource or other obligation. The conditions that give rise to uncertainty can change. Therefore it is important that uncertainty is assessed at each reporting date.” While recognition is viewed as a distinct stage in the accounting process, as outlined below, matters relevant to an assessment of existence uncertainty will have been considered in determining whether the item satisfies the definition of an element.

- ~~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

~~7.37.2~~ 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.

~~7.47.3~~ 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.

Staff proposed revisions to paragraph 7.3

Existence Uncertainty – existence of an element

7.3 Uncertainty about the existence of an element is addressed by assessing the available evidence in order to make a neutral judgment about whether an ~~element exists~~item satisfies all essential characteristics of the definition of that element, taking into account all available facts and circumstances at the reporting date. If the definition is not satisfied, an element does not exist and, as such, the item would not qualify for recognition as an element. However, as noted in paragraph 5.2 above, consistent with the requirements or guidance in an IPSAS, the item may be recognized as an other resource or other obligation. 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. Where an IPSAS specifies that a resource or obligation other than an element is to be recognized, uncertainty about the flows of service potential or economic benefits related to that resource or obligation is similarly taken into account in its measurement. 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

~~7.57.4~~ 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).~~

7.5 ~~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.

7.6 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.

Staff Comment: Paragraph 7.6 above was formerly paragraph 7.3. It has been moved to this position as directed by the IPSASB at its December 2013 meeting. It has not been shown in mark-up because there were no changes to its wording.

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 the 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.~~ They 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 ChapterPhase 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: Paragraph BC2 has been updated and BC3 included to reflect the decision to adopt Option D to identification of the elements of financial statements. These paragraphs draw together the explanation of changes from CF–ED2.

BC2. ~~CF–ED2 proposed that the elements of financial statements be identified as Assets, Liabilities, Revenue, Expenses, Deferred Inflows, Deferred Outflows, Ownership Contributions and Ownership Distributions. CF–ED2 explained that~~ 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 periodyear 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~~ CF–ED2 proposed that 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.

~~BC2-BC3.~~ A majority of respondents to CF–ED2 did not support the identification of deferred inflows and outflows as elements. However, many of those respondents acknowledged the issue that the IPSASB was attempting to respond to by identifying deferred inflows and deferred outflows as elements. They encouraged the IPSASB to consider other approaches to dealing with the issue. The IPSASB has responded to the views of respondents. This Chapter does not identify deferred inflows and deferred outflows as elements of the financial statements. Rather, it acknowledges that in some circumstances the elements as defined in this Chapter may not capture all the resources and obligations that should be presented in the financial statements of an entity consistent with the objectives of financial reporting. It provides that in these circumstances, IPSASs may require or allow recognition of resources or obligations that do not satisfy the definition of an element (referred to as “other resources” or “other obligations”). 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 directed that, whatever its final decision on the attribution of elements to particular financial statements, the BC should include an acknowledgement that the IPSASB had considered whether it is necessary to specify the elements that are to be recognized in the statement of financial position and the statement of financial performance. Paragraph BC4 below is intended to respond to that direction. It will need to be revised, and consequential changes made to other paragraphs, if the IPSASB determines that the Chapter will not specify the financial statements in which assets, liabilities, revenues and expenses are to be recognized.

BC4. 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 often 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. A number of amendments to this section of the BC (paragraphs BC5 to BC21) were reviewed and agreed at the September 2013 meeting, including amendments to paragraphs BC7 and BC8. Subsequent to that meeting additional amendments have 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 in paragraph 2.1 and 2.2. Some minor editorial and drafting amendments have also been made to, for example, ensure consistent usage of terminology and consistency of style.

A Resource

~~BC3-BC5.~~ ____ 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 Conceptual Framework confirms In stating in paragraph 2.2 that physical form is not a necessary condition of an asset, ~~the IPSASB acknowledged that m~~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-BC6.~~ ____ The IPSASB recognized that other rights to service potential or economic 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-BC7. 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 as a result of a past event 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 7 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 to ensure that the paragraph is not read as pre-empting the role of the recognition criteria), staff proposes that the second sentence use the phrase “satisfy the definition of an asset” rather than “give rise to assets”. The paragraph could also 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-BC8. Executory contracts are binding arrangements, where there is an unconditional promise to receive resources 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 satisfy the QCs will be considered at standards level.~~

Service Potential and Economic Benefits

~~BC8-BC9.~~ 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, ~~and decided that it should. In making this decision, t~~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-BC10.~~ 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: Old paragraph BC 10 has been deleted because it is a repeat of paragraph 2.6 as included in CF-ED2. 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 ~~the following should be identified as essential characteristics of an asset:~~ (a) legal ownership, (b) the ~~ability-right to allow~~ access, ~~to and/or, 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, ~~are 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 question~~ed~~ 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 service potential or economic 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 ~~11BC13 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 also 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 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 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 and/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. It may also be useful 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 not necessary 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-emphasis~~ 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 identified as 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~~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

~~BC24: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-present 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 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 that were not legal 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 BC334 discusses ~~non-legal~~other binding obligations.

Staff comment: The marked up amendments to the following paragraphs BC23, BC24, and BC 29 were agreed at the September 2013 meeting. Amendments to BC 25, BC 26 and BC 27 were also agreed at that meeting, but these paragraphs have been further developed to acknowledge concerns

raised by respondents to CF–ED2, to remove some repetition and deal with minor editorial refinements. All amendments are retained in mark-up to allow Members to identify 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 issuelevel 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 future event outside the entity's control occurs (or fails to occur). The liability is the unconditional obligation to provide a service, which results in an outflow of economic benefits. The term stand-ready obligation is used to describe 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 (or does not occur). 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. 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.

~~BC25-BC26.~~ 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 outlines some public sector circumstances that have led to the IPSASB's view on this matter.

~~BC26-BC27. The IPSASB formed a view that the notion of a stand-ready obligation is workable and valuable 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. In such circumstances there may be an identifiable past event and an outflow of resources, although the exact identity of the party to whom settlement will be made will not generally be known. 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~~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 ongoing provision 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 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

~~BC27-BC28.~~BC28. 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.

~~BC28-BC29.~~BC29. 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 that 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~~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

~~BC29-BC30.~~ The IPSASB considered whether the definition of a liability should require the existence of a past transaction or other event. Some commentators contend that identification of a past event is not an essential characteristic of a liability and that, there is consequently, there is 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.

~~BC30-BC31.~~ 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 that a past event be identified as a characteristic of a liability. 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: Proposed amendments to paragraphs BC32 to BC37 were included in the draft provided for review at the December 2013 IPSASB meeting but, because of time constraints were not considered at that meeting. For the most part they are editorial in nature, but paragraph BC 35 has been revised to explain the term “other binding obligations” and remove duplication of the text of paragraph 3.11 In addition, staff propose insertion of the new paragraph BC 32 to explain that the IPSASB considered but decided not to remove the phrase “*little or no*” from the description of a present obligation.

~~BC31-BC32.~~ 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. They 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 intention 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.

~~BC32-BC33.~~ 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 d~~D~~etermining when a present obligation arises in a public sector context is complex and, in some cases, could be considered arbitrary. This is particularly so when considering whether liabilities can arise from obligations that are not enforceable by legal or equivalent means. 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. Some may be concerned that that s~~S~~uch variation does not promote consistency in reporting of these

obligations as liabilities, 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.

~~BC33:~~BC34. A converse view is that where a government has a record of honoring obligations, failing to recognize them as liabilities 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.

~~BC34:~~BC35. 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, paragraph 3.11 of this Chapter identifies the attributes that - ~~The IPSASB considers that an~~ non-legal other binding obligation is to possess for it to which gives rise to a liability. ~~has 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.~~

~~BC35:~~BC36. 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, in these circumstances, an ~~non-legal~~ other binding obligation gives rise to a liability the availability of funding to settle the obligation may be a persuasive indicator.

Sovereign Power to Avoid Obligations

~~BC36:~~BC37. 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.

Commitments

Staff comment: Paragraph BC 38 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.

BC38. 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

Staff comment: Section 4 has been updated to acknowledge responses to CF-ED2 and reflect the decision to adopt the Option D approach to the identification of the elements.

~~BC37-BC39.~~ CF-CP2 explained that o~~ne~~ approach to defining revenue and expenses is to take the view that these~~se elements~~ can be derived from changes in assets and liabilities.~~.-The IPSASB acknowledged-It noted~~ that this approach has been adopted by many standard-setters globally. CF-CP2 also noted that a~~n~~other view is that revenue and expenses are flows that relate to the current period. CF-CP2 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.~~n.~~

BC40. CF-ED2 reflected~~The IPSASB formed~~a view that revenue and expenses should be defined to~~a~~ focus on the current year activities of~~the a public sector entity. It 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 timing restrictions specifying their use in future periods would be misleading. This led to the conclusion that,~~explained that,~~ in precisely defined circumstances, certain inflows and outflows of resources would~~do~~ not meet the definition of revenue and expenses, but rather are deferred inflows and deferred outflowswhich should be identified as separate elements of the financial statements. CF-~~

~~ED2. The rationale for defining deferred inflows and deferred outflows as elements is further considered in BC40-BC43. The IPSASB took the view proposed that that the definitions of revenue and expenses should be defined to reflect the inflows of resources used to finance such goods and services and the outflows of resources related to providing those goods and services in the reporting period. Consequently, revenues and expenses were defined as inflows and outflows of resources during the period that increased or decrease net assets other than deferred inflows, deferred outflows, ownership contributions and ownership distributions.~~

BC41. As noted in paragraph BC3, a majority of respondents to CF-ED2 did not support the identification of deferred inflows and outflows as elements and the resultant definitions of revenue and expenses. However, some of those respondents acknowledged that the definitions of assets, liabilities, ownership contributions, and ownership distributions included in CF-ED and definitions of revenues and expenses derived from changes in assets and liabilities may not capture all the economic phenomena that should be reported in the financial statements or the notions of financial performance that may be useful to users.

BC42. The IPSASB was persuaded by these arguments and has responded to the views of respondents. The Chapter does not identify deferred inflows and deferred outflows as elements, but acknowledges that ~~It acknowledges that an IPSASs that deals with particular transactions or other events~~ may require or allow some resources or obligations that do not satisfy the definition of an asset or a liability to be recognized in the financial statements when necessary to achieve the objectives of financial reporting. Consequently, the definitions of revenue and expenses have been revised to encompass transactions and other events that change net financial position, rather than net assets — because in certain circumstances specified by IPSASs, resources and obligations other than assets and liabilities may be recognized in the financial statements. ~~It is of the view~~

BC43. The IPSASB is of the view that the concepts applicable to financial reporting, and the notions of financial performance and financial position to be reflected in financial statements will continue to evolve over time in the light of the experience of preparers, users and standard setters. As noted in the Preface, this Conceptual Framework is to be viewed as a living document. Consequently, the identification of elements of financial statements as identified in this document may be developed further in the future.

<p>Staff comment: The Preface to the Conceptual Framework does not currently acknowledge that the Framework is a living document. However, staff is of the view that if Option D is adopted it would be appropriate to include such an observation in the Preface.</p>

Revenue

~~BC38-BC44.~~ The IPSASB considered whether the definition of revenue should be the “net” or “gross” increase in “net” assets financial position. 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.

~~BC39-BC45.~~ 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

~~BC40-BC46.~~ 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.

~~BC41-BC47.~~ As discussed in more detail in BC~~5148~~BC530, 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: Other resources or obligations~~Deferred Inflows and Deferred Outflows~~

Staff comment: Section 5 has been updated to acknowledge responses to CF-ED2 and outline the matters and approaches explored by the IPSASB as it moved to its final decision on the elements.

It has also been updated to respond to the IPSASB direction at its September 2013 meeting that 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.

BC48. Responses to CF-CP2 and CF-ED2 indicate that measures of financial performance that reflect (a) changes in net assets or net financial position during the reporting period; and (b) the inflows and outflows of flows of resources that relate to the activities of the current period, are both seen as relevant and useful to users of GPFs. In responding to the views of respondents, the IPSASB considered whether –the Conceptual Framework should simply identify the characteristics of the elements and provide guidance on how these elements may be assembled to present information about each of these measures of financial performance. The composition and type of the financial statements that would be used to present the elements, and the measures of performance that they

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

were to reflect, would then be specified at standards level, and may evolve over time and be influenced and enhanced by jurisdictional considerations. However, as noted in paragraph BC4, the IPSASB concluded that while such an approach had merit, the Conceptual Framework should provide clear direction on the elements that were to be recognised in the statement of financial position and statement of financial performance

BC49. In developing this Chapter of the Conceptual Framework the IPSASB considered a number of potential approaches to identifying the elements of financial statements that would best achieve the objectives of financial reporting and respond to the concerns and views of respondents to CF-CP2 and CF-ED2 and those that provided input at other forums and components of the IPSASB's consultative process. These approaches are outlined below. The IPSASB acknowledges that each approach has strengths but also some shortcomings. The IPSASB is of the view that the approach reflected in this Chapter is one that allows relevant measures of performance to be presented in GFRs, best responds to the concerns of constituents and provides a mechanism for financial reporting to further evolve to respond to users information needs.

Approaches considered by the IPSASB and, in some cases explained in CF-CP2 and proposed for adoption in CF-ED2 include ~~Nature of Deferred Inflows and Deferred Outflows~~

~~BC50. As identified in Key Characteristics a 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 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 considers:~~

~~BC42. d:~~

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

~~BC43-BC51.~~ The IPSASB considered that broadening the definition of an asset and liability distorts the essence of these elements, because ~~it may for example, in the case of assets, it would lead to identifying as assets including~~ resources that an entity does not, in substance, control and

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

~~identifying as in the case of~~ liabilities obligations that are not present obligations. Such an approach would not be ~~transparent or~~ easily understandable to many users and may conflict with ~~other the~~ QCs ~~including relevance and 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.

~~BC52. Presentational approaches can be used to provide information about period flows as well as changes in the resources available to support the provision of services in future periods and claims to those resources. 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.~~ A number of respondents to CF-ED2 noted that presenting information about ~~The IPSASB considered that dealing with inflows and outflows of resources that relate to the present and/or future periods~~ ~~deferred inflows and deferred outflows~~ through note disclosure is ~~contrary to the principle that disclosure is not a substitute for their~~ recognition, ~~which is stated in Section 7.~~

~~BC44-BC53.~~ Some constituents expressed the view that approaches that define revenue and expenses by reference to changes in assets and liabilities exclude the possibility that in some, albeit rare, circumstances, resources and obligations that arise from some transaction or other events and do not satisfy the definition of any of the elements may need to be recognized to enable the financial statements to provide information useful for accountability and decision purposes. They argue that these circumstances can and do arise and, in the absence of any allowance for ~~their separate recognition~~ such resources and obligations are tenuously or erroneously classified as one of the defined elements, with deleterious effects on transparency and assessments of financial performance and financial position. Some of these constituents note that the Framework should simply acknowledge that this may occur and that it will be dealt with at standards level.

~~BC54.~~ CF-ED2 proposed that Deferred Inflows and Deferred Outflows should be defined as separate elements of the statement of financial position, and provided detailed guidance on the circumstances in which they should be recognized. In the process of finalizing CF-ED2, ~~the~~ ⁴⁴he IPSASB considered whether deferred inflows and deferred outflows should be identified as elements of the statement of financial performance, and thus allow measures of both changes in net assets and period flows to be presented in that statement. However, the IPSASB rejected this approach because of concerns that it would require recycling of deferred inflows and outflows to revenues and expenses in future periods, and this would unnecessarily complicate and undermine the understandability of the financial statements. ~~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.~~

~~BC45-BC55.~~ As noted in paragraph BC3, while some respondents supported the approach proposed in CF-ED2 the majority of respondents did not support identifying DI and DO as elements. The IPSASB has responded to input from constituents. While the Conceptual Framework no longer identifies Deferred Inflows and Deferred Outflows as elements, the IPSASB remains of view that presentation of information about period flows is important and should be addressed through presentation.

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

- ~~BC46. 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.~~
- ~~BC47. 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.~~
- ~~BC48. 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 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 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: Paragraphs BC 56 below has been updated to reflect the IPSASB's decision at its meeting in December 2013 to adopt Option D to the identification of the elements of the financial statements.

- ~~BC49-BC56. Net assets is the difference between assets and liabilities. This Conceptual Framework e~~
~~IPSASB's decision to acknowledges that IPSASs may in some circumstances require the~~
~~recognition of resources or obligations other than those that satisfy the definition of an element in~~
~~the statement of financial position. 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 net assets and other resources and

other obligations recognized in the statement of financial position ~~deferred outflows less an entity's liabilities and deferred inflows~~ at the reporting date. The IPSASB anticipates that for most public sector entities the amounts of net assets and net financial position will not differ, or not differ materially. In these cases, ~~A positive net assets/net financial position will represent~~ represents the ~~net~~ resources available for providing ~~goods or~~ services in future periods and the claims against those resources. ~~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, where resources and obligations other than those encompassed by the elements are recognized in the financial statements, the amounts reported as net assets and net financial position may differ. In these circumstances, the interpretation of net financial position and its relationship to net assets will be determined by reference to the nature of the additional resources and obligations recognized in the financial statements.

~~BC50-~~BC57. The IPSASB considered whether net assets or, if appropriate, 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.

~~BC51-~~BC58. 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 assets and net financial position are a residual amounts that should not be defined. ~~Treating net financial position in such a way is more straightforward and understandable.~~

Staff comment: The amendments to the final sentence of paragraph BC59 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.

~~BC52-~~BC59. However, the IPSASB acknowledged that part of net assets or 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 assets or 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 the Definition of the Elements~~Disclosure~~

~~BC53-BC60.~~ The IPSASB considered whether all recognition criteria should be integrated in definitions of the elements. The IPSASB acknowledged the view that the inclusion of recognition criteria in definitions of the elements enables preparers to consider all the factors that must be taken into account in evaluating whether an item of information is recognized as an element in the financial statements. However, the IPSASB took the view that while there is overlap in factors to be considered in determining whether an item satisfies the definition of an element and whether that element qualifies for recognition, particularly in respect of whether the recognition criteria of existence uncertainty is met, recognition is should be considered as a distinct ~~stage~~phase in the financial reporting process. This is because recognition embraces consideration of factors broader than whether the definition of an element is satisfied and may apply to the recognition of items that do not satisfy the definition of an element. 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: –For the most part amendments to paragraphs BC60 to BC67 are proposed to acknowledge the overlap of recognition and definition of the elements.

The addition of the final sentence of paragraph BC64 was agreed by the IPSASB at its meeting in September 2013. Other amendments to paragraph BC 64 are proposed to focus on reservations about the threshold approach and to acknowledge that similar risks may also arise under other approaches to recognition, but that an approach based on an assessment of all available evidence is more likely to satisfy the QCs.

~~BC54-BC61.~~ In determining whether an element should be recognized there are two types of uncertainty that need to be considered. The first is existence uncertainty–matters that will have been considered in determining 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

~~BC55-BC62.~~ 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.

~~BC56-BC63.~~ 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.

~~BC57-BC64.~~ 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 and may not meet. 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 acknowledges that such risks can also exist for approaches which do not specify thresholds for recognition. This is because preparers will make their own assessments of the circumstances or "the threshold" that justifies recognition and those assessments can change for different items and over time. However, tThe IPSASB ~~therefore~~ concluded that, on balance, an approach that is based on an assessment of all available evidence ~~should be assessed~~ in determining whether an element exists and takes ~~that account of~~ uncertainty about the flows of service potential or economic benefits ~~should be taken into account~~ in measurement is a more appropriate response to the uncertainty faced by preparers of financial statements. It is more likely to result in the recognition of information that satisfies the QCs than is the establishment of an arbitrary threshold that must be adhered to. 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.

~~BC58-BC65.~~ 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.

~~BC59-BC66.~~ 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. As noted in paragraph BC60 these matters will also have been considered in determining whether an item satisfies the definition of an element.

~~BC60-BC67.~~ 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 BC68 was approved at the September 2013 meeting. It is presented in mark-up here to allow Members to identify changes to CF-ED2. Amendments to BC69 have been made to acknowledge responses to CF-ED2

Measurement Uncertainty

BC68. 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

~~BC61-BC69.~~ 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.

ATTACHMENT: ALTERNATIVE VIEWS AND IASB and GFS APPENDICES INCLUDED IN CF—ED2.

Alternative Views

Staff comment: The following paragraphs identifying Alternative Views and the appendices identifying differences from IASB and GFS approaches will not be included in the final Chapter, consistent with the IPSASB's decisions on the form and content of the Conceptual Framework.

They are included here as an Attachment to allow Members to refer to them if useful.

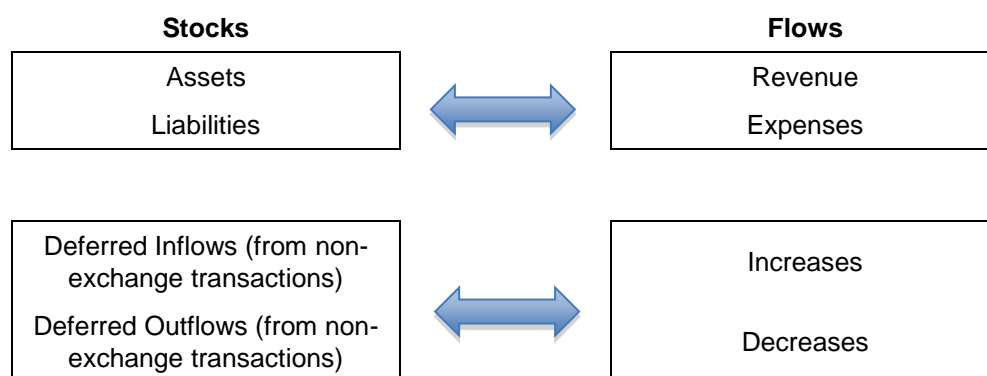
Alternative View of Prof. Mariano D'Amore

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

THIS DRAFT FOR IPSASB REVIEW MARCH 2014

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Staff Note: Formatting, 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

- 1.1 This Chapter defines the elements used in general purpose financial statements (financial statements) of governments and other public sector entities (public sector entities) and provides further explanation about those definitions. It also deals with recognition.

Elements and their Importance

Staff comment: Amendments to paragraph 1.2 to reflect that ownership contributions and ownership distributions are not elements of the statement of financial position were agreed at the IPSASB's meeting in September 2013. Further amendments to paragraph 1.2 and the addition of paragraph 1.4 reflect the decision to adopt Option D to identification of the elements.

- 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 and liabilities. 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 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. Presentation is addressed in Chapter 7 *Presentation in General Purpose Financial Reports* of this Conceptual Framework.
- 1.4 In some circumstances, to ensure that the financial statements provide information that is useful for a meaningful assessment of the financial performance and financial position of an entity, recognition of economic phenomena that are not captured by the elements as defined in this Chapter may be necessary. Consequently, the identification of the elements in this Chapter does not preclude IPSASs from requiring or allowing the recognition of resources or obligations that do not satisfy the definition of an element identified in this Chapter (hereafter referred to as "other resources" or "other obligations") when necessary to better achieve the objectives of financial reporting.

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 and Approach to Recognition

Staff Comment: Paragraphs 1.5 and 1.7 have been revised to reflect that DI and DO are not identified as elements and other consequences of Option D. As noted in the covering issues paper, questions of terminology are to be resolved at this meeting.

1.5 The elements that are defined in this Chapter are:

- (a) Assets;
- (b) Liabilities;
- (c) Revenue;
- (d) Expenses;
- (e) Ownership contributions; and
- (f) Ownership distributions.

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

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

1.7 Net financial position is the net assets of an entity and the net amount of other resources less other obligations recognized in the statement of financial position at the reporting date. It can be represented by:

$$\text{Assets} - \text{Liabilities} + (\text{Other resources} - \text{Other Obligations}) = \text{Net Financial Position}$$

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: Staff has deleted "old" paragraph 1.9 given that existence uncertainty will be relevant in determining whether an item satisfies the definition of an element. This deletion is subject to the Board decision on the explanation of recognition at this meeting.

Staff Comment: "Old" paragraph 1.10 has been deleted for consistency with the 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. This amendment was agreed at the IPSASB meeting in September 2013.

2. Assets

Definition

2.1 An asset is a resource that an entity presently controls as a result of a past event.

Staff Comment: The above construction of paragraph 2.1 was discussed and agreed at the September and December 2013 meetings.

Amendments to paragraphs 2.2 and 2.4 below were agreed at the September 2013 meeting. The first sentence of paragraph 2.3 below has been deleted in this draft—because this is the primary focus of paragraph 2.2 as revised, and some minor editorial amendments have been processed.

A Resource

2.2 A resource is an item with the ability to provide service potential or economic benefits. Physical form is not a necessary condition of a resource. The service potential or economic 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.

2.3 Service potential is the capacity of an asset to be used by the entity to provide 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 services to third parties. Such services may be for collective or individual consumption. Many 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 *Preface to the Conceptual Framework*),⁴ many assets that embody service potential are specialized in nature.

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 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.

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

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

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

An Entity Controls

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.

The section heading has been revised to reflect that the section deals with control.

- 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.
- 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 resource is 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.

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 results from a past event.

A Present Obligation

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

Staff comment: Amendments to paragraphs 3.1 and 3.2 above were agreed at IPSASB meetings in September and December 2013. Subject to IPSASB agreement at this (March 2014) meeting, Staff proposes that the term “other binding obligations” be replaced by “non-legally binding obligations” throughout the Chapter.

An Outflow of Resources from the Entity

- 3.3 A liability must involve an outflow of resources 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 to this point as a consequence of the identification and clarification of the characteristics of a present obligation and a liability at IPSASB meetings in September and December 2013. 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.

Past Event

- 3.4 The complexity of public sector programs and activities means that, particularly for binding 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 necessary 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 resources from the entity.

Little or No Realistic Alternative to Avoid

Legal and Other Binding Obligations

- 3.5 Binding obligations can be legal obligations or other binding 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.

- 3.6 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

- 3.7 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 law⁵. 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.
- 3.8 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 binding obligation that is not enforceable in law (see paragraphs 3.11–3.13).

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 paragraph⁵ to retain the intent but avoid the troublesome term.

- 3.9 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— or 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.
- 3.10 Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this Framework and therefore cannot be recognized. The position should

⁵ References to obligations enforceable in law encompass legal obligations and binding obligations subject alternative processes with equivalent effect.

be assessed at each reporting date to consider if the legal position has changed and to determine whether a liability still exists.

Other Binding Obligations

- 3.11 Liabilities can also arise from other binding obligations. Other binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal action to enforce settlement. Other binding obligations that gives rise to liabilities have 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.
- 3.12 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 the budget (which may be two distinct points); and
 - (d) The budget becoming effective (in some jurisdictions the budget will not be effective until an appropriation has been effected).
- 3.13 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 an obligation gives rise to a 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 resources 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 has little or no realistic alternative to 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 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 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 resources 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 other binding obligation exists. However the absence of a budgetary provision may not, by itself be a reason for not recognizing a liability.

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

4. Revenue and Expenses

Staff comment: The definition and explanation of revenue and expenses in the following paragraphs have been revised to reflect the decision to adopt Option D to identification of elements. The terms “net financial position”, “other resources” and “other obligations” have been used in the definition of revenue and expenses in this draft. However, this terminology is still subject to agreement by the IPSASB. This section will be revisited following IPSASB discussion and directions at this meeting.

Definitions

4.1 Revenue is:

- (a) Increases in assets and other resources and reductions in liabilities during the current reporting period that increase the net financial position of an entity, other than ownership contributions; and
- (b) Reductions in amounts recognized as other obligations in previous reporting periods.

4.2 Expenses are:

- (a) Increases in liabilities and other obligations and reductions in assets during the current reporting period that decrease the net financial position of an entity, other than ownership distributions; and
- (b) Reductions in amounts recognized as other resources in previous periods.

Increases and Decreases in Net Financial Position

- 4.3 Revenues and expenses provide users with information about changes in an entity's resources and obligations during a period from service delivery and other activities, other than those changes that arise as a consequence of contributions from or distributions to owners. Such information informs assessments of the net financial position of the entity and the reasons for changes therein over the reporting period. As noted in paragraph 1.4, this Conceptual Framework acknowledges that all economic phenomena that should be reported in GPFSS consistent with the objectives of financial reporting may not be captured by changes in assets and liabilities as defined. Therefore, revenues and expenses are defined to encompass changes in assets and liabilities and other resources and other obligations that contribute to a change in the net financial position of the entity over the reporting period and are recognized in the statement of financial position consistent with the requirements of IPSASs.
- 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 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 Chapter 6 *Measurement of Assets and Liabilities in Financial Statements* of the Conceptual Framework outlines the measurement bases that may be adopted for financial reporting purposes. It explains that IPSASs will include requirements and provide guidance on the bases that may be adopted for the measurement of revenues and expenses arising from particular transactions or other events.

Staff comment: At its September 2013 meeting the IPSASB noted that the first sentence of paragraph 4.5 reflected that all changes in the value of assets and liabilities would be included as revenue and/or expenses, and agreed that this explanation should be revisited. Paragraph 4.5 has been amended to remove that sentence, delete reference to deferred inflows and deferred outflows and to link to Chapter 6 which deals with measurement of the elements.

- 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.
- 4.8 Public sector entities typically have an operating and funding model (sometimes called a business model). The net result of those revenues designated to fund operations during the reporting period, and those expenses incurred as part of its operating model, will be represented either as a surplus or deficit. The net result provides information on the financial performance of the operating and funding model. If a surplus, this measure provides an indicator of the ability of the entity to reduce demands on resources from resource providers, increase services provided to recipients, or to increase the financial resilience of the entity by, for example, reducing debt, or any combination thereof. If a deficit, this measure provides an indicator of the need to increase demands on resources from resource providers, reduce services provided to service recipients, or to reduce the financial resilience of the entity by, for example, increasing debt, or any combination thereof.
- 4.9 This Conceptual Framework does not define "revenues designated to fund operations during the reporting period", nor "expenses incurred as part of its operating model" as separate elements. IPSAS may however make such classifications of items to respond to the information needs of service recipients and resource providers as identified in Chapter 2 of this Conceptual Framework.

Other Resources and Obligations

Staff comment: The paragraphs dealing with the definition and explanation of deferred inflows and deferred outflows have been deleted to reflect the decision to adopt Option D to identification of the elements. Paragraphs 5.1 and 5.2 explain that IPSASs may require or allow resources or obligations that do not satisfy the definition of an element to be recognized when considered necessary to achieve the objectives of financial reporting.

- 5.1 Chapter 2 of the Conceptual Framework identifies the objectives of financial reporting as the provision of information useful for accountability and decision making purposes, outlines the information users will need for those purposes and explains the role of financial statements and other GPFRs in providing such information. Chapter 2 notes that for accountability and decision making purposes users will need information about such matters as:
- (a) The performance of the entity during the reporting period in meeting its service delivery and financial objectives, managing the resources it is responsible for, and complying with relevant budgetary and other authority regulating the raising and use of resources; and
 - (b) The liquidity and solvency of the entity and the sustainability of the entity's service delivery and other operations over the long term, and changes therein as a result of the activities of the entity during the reporting period including, for example, changes to its financial and operating capacity.
- 5.2 In some cases, in developing or revising an IPSAS, the IPSASB may determine that to achieve the objectives of financial reporting a resource or obligation that does not satisfy the definition of an element should be presented in the financial statements. In these cases, the IPSAS may require or allow these resources or obligations to be recognized as "other resources" or "other obligations", being classes of items additional to the elements.

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

Net Assets and Net Financial Position

Staff comment: The amendments to paragraphs 6.1 and 6.2 below have been made to reflect adoption of Option D to identification of the elements, and to acknowledge that Ownership Contribution and Ownership Distributions are not elements of the statement of financial position.

- 6.1 Net assets is the difference between assets and liabilities. Net financial position is the difference between assets and liabilities after adding other resources and deducting other obligations recognized in the statement of financial position. As noted in paragraph 1.8, neither net assets nor net financial position are elements.
- 6.2 All items that meet the definition of assets and liabilities, and satisfy the recognition criteria set out in Section 7 of this Chapter are reported on the statement of financial position. Except where an IPSAS requires or allows an item that does not satisfy the definition of an asset or liability to be recognized in the statement of financial position as an other resource or an other obligation, net assets and net financial position will both be determined as the difference between assets and liabilities. Net assets and net financial position can be a positive or negative residual amount. Ownership contributions and ownership distributions are reported in other financial statements included in GPFRs.

Ownership Contributions and Ownership Distributions

Definitions

Staff comment: The amendments to the definition of ownership contributions and ownership distributions in paragraph 6.3 and 6.4 were agreed at the December 2013 meeting, and the amendments to the first sentence of paragraph 6.5 have been included as a consequence.

The addition of the final sentence of 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.

- 6.3 Ownership contributions are inflows of resources to an entity, contributed by external parties in their capacity as owners, 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 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, including those inflows that initially establish the ownership interest, and outflows of resources to owners in their capacity as owners, from revenue and expenses. 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.
- 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

Staff comment: At its December 2013 meeting the IPSASB directed that “old” paragraph 7.2 be relocated to follow the paragraph dealing with measurement uncertainty. The IPSASB also agreed that the discussion of existence uncertainty needed some revision to clarify the relationship of existence uncertainty to satisfaction of the definitions of an element.

Paragraph 7.2 has been relocated as directed. Boxed text following paragraphs 7.1 and 7.3 identifies staff proposed revisions to those paragraphs, including revisions intended to embrace consequences of adoption of Option D on the identification of elements.

The amendments to paragraph 7.4 were agreed at the September 2013 meeting the IPSASB.

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.

Staff propose that paragraph 7.1 be split into two and revised as outlined below

“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 of, and constraints on, information included in GPFRs. All items that satisfy the definition of an element and the recognition criteria are recognized in the financial statements. In some circumstances, an IPSAS may also specify that, to achieve the objectives of financial reporting, a resource or obligation that does not meet the definition of an element is to be recognized in the financial statements provided it can be measured in a way that meets the QCs and constraints.

7.2 Recognition involves an assessment of uncertainty related to the existence and measurement of the element or other resource or other obligation. The conditions that give rise to uncertainty can change. Therefore it is important that uncertainty is assessed at each reporting date. While recognition is viewed as a distinct stage in the accounting process, as outlined below, matters relevant to an assessment of existence uncertainty will have been considered in determining whether the item satisfies the definition of an element.

Existence Uncertainty

- 7.2 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 event creates an item that meets the definition of an element, because entities operate in uncertain environments.

- 7.3 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.

Staff proposed revisions to paragraph 7.3

Uncertainty – existence of an element

7.3 Uncertainty about the existence of an element is addressed by assessing the available evidence in order to make a neutral judgment about whether an item satisfies all essential characteristics of the definition of that element, taking into account all available facts and circumstances at the reporting date. If the definition is not satisfied, an element does not exist and, as such, the item would not qualify for recognition as an element. However, as noted in paragraph 5.2 above, consistent with the requirements or guidance in an IPSAS, the item may be recognized as another resource or other obligation. 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. Where an IPSAS specifies that a resource or obligation other than an element is to be recognized, uncertainty about the flows of service potential or economic benefits related to that resource or obligation is similarly taken into account in its measurement. 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

- 7.4 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 Chapter 6, *Measurement of Assets and Liabilities in Financial Statements*.
- 7.5 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.
- 7.6 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.

Staff Comment: Paragraph 7.6 above was formerly paragraph 7.3. It has been moved to this position as directed by the IPSASB at its December 2013 meeting. It has not been shown in mark-up because there were no changes to its wording.

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. Respondents to the 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. They 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 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: Paragraph BC2 has been updated and BC3 included to reflect the decision to adopt Option D to identification of the elements of financial statements. These paragraphs draw together the explanation of changes from CF–ED2.

- BC2. CF–ED2 proposed that the elements of financial statements be identified as Assets, Liabilities, Revenue, Expenses, Deferred Inflows, Deferred Outflows, Ownership Contributions and Ownership Distributions. CF–ED2 explained that as a result of the nature of activities undertaken in the public sector, a focus on the activities of the current reporting period 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, CF–ED2 proposed that 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.
- BC3. A majority of respondents to CF–ED2 did not support the identification of deferred inflows and outflows as elements. However, many of those respondents acknowledged the issue that the IPSASB was attempting to respond to by identifying deferred inflows and deferred outflows as elements. They encouraged the IPSASB to consider other approaches to dealing with the issue. The IPSASB has responded to the views of respondents. This Chapter does not identify deferred inflows and deferred outflows as elements of the financial statements. Rather, it acknowledges that in some circumstances the elements as defined in this Chapter may not capture all the resources and obligations that should be presented in the financial statements of an entity consistent with the objectives of financial reporting. It provides that in these circumstances, IPSASs may require or allow recognition of resources or obligations that do not satisfy the definition of an element (referred to as “other resources” or “other obligations”).

Financial Statements

Staff Comment. At its September 2013 meeting, the IPSASB directed that, whatever its final decision on the attribution of elements to particular financial statements, the BC should include an acknowledgement that the IPSASB had considered whether it is necessary to specify the elements that are to be recognized in the statement of financial position and the statement of financial performance. Paragraph BC4 below is intended to respond to that direction. It will need to be revised, and consequential changes made to other paragraphs, if the IPSASB determines that the Chapter will not specify the financial statements in which assets, liabilities, revenues and expenses are to be recognized.

- BC4. 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 often perceived to be, the primary vehicles for communicating information about financial position and performance to users of GPFs, and the Conceptual Framework should provide clear direction on the elements that were to be recognised in them.

Section 2: Assets

Staff Comment. A number of amendments to this section of the BC (paragraphs BC5 to BC21) were reviewed and agreed at the September 2013 meeting, including amendments to paragraphs BC7 and BC8. Subsequent to that meeting additional amendments have 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 in paragraph 2.1 and 2.2. Some minor editorial and drafting amendments have also been made to, for example, ensure consistent usage of terminology and consistency of style.

A Resource

- BC5. In the public sector, an asset is a resource with the ability to provide service 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 Conceptual Framework confirms that physical form is not a necessary condition of an asset. 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.
- BC6. The IPSASB recognized that other rights to service potential or economic 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 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.

Unconditional Rights

- BC7. Unconditional rights 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 unconditional rights that represent service potential or economic benefits that are controlled by the entity as a result of a past event give rise to assets. Whether such assets qualify for recognition will be dependent on whether recognition criteria have been satisfied.

Staff Comment: Revisions to BC 7 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 to ensure that the paragraph is not read as pre-empting the role of the recognition criteria), staff proposes that the second sentence use the phrase “satisfy the definition of an asset” rather than “give rise to assets”. The paragraph could also acknowledge that additional guidance dealing with particular circumstances may be provided at standards level. The paragraph would then read

“Unconditional rights 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 unconditional rights that represent service potential or economic benefits that are controlled by the entity satisfy the definition of an asset. Whether such assets qualify for recognition will be dependent on whether recognition criteria have been satisfied. Additional guidance on circumstances where unconditional rights give rise to an asset may be provided at standards-level.”

Executory Contracts

- BC8. Executory contracts are binding arrangements, where there is an unconditional promise to receive resources 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. 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 satisfy the QCs will be considered at standards level.

Service Potential and Economic Benefits

- BC9. The term “service potential” has been used to identify the capacity of an asset to provide 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 should include a reference to both service potential and economic benefits, and decided that it should. In making this decision, 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 services, generally in non-exchange transactions, 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.

- BC10. The IPSASB therefore concluded that because the primary objective of most public sector entities is to deliver 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 should include both the terms service potential and economic benefits.

An Entity Controls

Staff Comment: Old paragraph BC 10 has been deleted because it is a repeat of paragraph 2.6 as included in CF-ED2. 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 of an asset or whether other indicators such as the following should be identified as essential characteristics of an asset: (a) legal ownership, (b) the right to access, and to restrict or deny the access of external parties to, the resource, (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. 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 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 questioned whether a resource that cannot be used to meet an entity’s objectives gives rise to an asset, 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 service potential or economic 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 paragraph 11 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 whether the resource constitutes an asset of the entity.

BC16. The IPSASB also considered 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.

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 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 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 and/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. It may also be useful 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

- 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 event is not necessary 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 emphasis 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 resource. Some may also accept that a past event might provide useful supporting evidence of the existence of an asset.
- BC19. Many respondents to CF-CP2 and CF-ED2 took the view that a past event should be identified as 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 resource might arise and therefore identification of the appropriate past event is crucial in identifying whether an asset exists.
- BC20. As highlighted in the *Preface to the Conceptual Framework* the powers and rights of government are particularly significant for the identification 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 resource and asset of the entity.
- 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

- BC22. In considering when obligations are present obligations, the IPSASB accepted that a legal obligation gives rise to a present obligation. What is a present 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 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 obligations that were not legal 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 other binding obligations was the most straightforward and understandable approach. Paragraph BC33 discusses other binding obligations.

Staff comment: The marked up amendments to the following paragraphs BC23, BC24, and BC 29 were agreed at the September 2013 meeting. Amendments to BC 25, BC 26 and BC 27 were also agreed at that meeting, but these paragraphs have been further developed to acknowledge concerns raised by respondents to CF–ED2, to remove some repetition and deal with minor editorial refinements. All amendments are retained in mark-up to allow Members to identify changes to CF-ED2.

Conditional and Unconditional Obligations

- 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 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 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.
- 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

- BC25. Stand-ready obligations are obligations that require an entity to be prepared to fulfill an obligation if a specified uncertain future event outside the entity’s control occurs (or fails to occur). The liability is the unconditional obligation to provide a service which results in an outflow of economic benefits. The term stand-ready obligation is used to describe 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 (or does not

occur). 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. 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.

- BC26. 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 outlines some public sector circumstances that have led to the IPSASB's view on this matter.
- BC27. 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 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, should be considered at the standards level consistent with the principles established in this Conceptual Framework.

Performance Obligations

- BC28. 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.
- BC29. 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 that 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. Performance obligations are often conditional obligations. Determining whether such obligations give rise to liabilities is dependent upon the terms of particular binding agreements and may vary between jurisdictions.

Past Event

- BC30. The IPSASB considered whether the definition of a liability should require the existence of a past transaction or other event. Some commentators contend that identification of a past event is not an essential characteristic of a liability and that, consequently, there is 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 exists at the reporting date.
- BC31. The IPSASB acknowledged this view, but also noted that many respondents to CF-CP2 and CF-ED2 considered it necessary that a past event be identified as a characteristic of a liability. 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: Proposed amendments to paragraphs BC32 to BC37 were included in the draft provided for review at the December 2013 IPSASB meeting but, because of time constraints were not considered at that meeting. For the most part they are editorial in nature, but paragraph BC 35 has been revised to explain the term “other binding obligations” and remove duplication of the text of paragraph 3.11 In addition, staff propose insertion of the new paragraph BC 32 to explain that the IPSASB considered but decided not to remove the phrase “*little or no*” from the description of a present obligation.

- BC32. 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. They 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 intention 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.
- BC33. Interpreting the term “little or no realistic alternative to avoid” in the context of a present obligation is a crucial issue in public sector financial reporting. Determining when a present obligation arises in a public sector context is complex and, in some cases, could be considered arbitrary. This is particularly so when considering whether liabilities can arise from obligations that are not enforceable by legal or equivalent means. 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. Some may be concerned that that such variation does not promote consistency in reporting of these obligations as liabilities, and can mean that information reported on liabilities does not meet the QC of

understandability. This may lead to a view that an essential characteristic of a liability should be that it is enforceable at the reporting date by legal or equivalent means.

- BC34. A converse view is that where a government has a record of honoring obligations, failing to recognize them as liabilities 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.
- BC35. On balance, the IPSASB agreed with those who argue that, in the public sector, liabilities can arise from 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, paragraph 3.11 of this Chapter identifies the attributes that an other binding obligation is to possess for it to give rise to a liability.
- BC36. 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 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 32, might give rise to a liability. In assessing whether, in these circumstances, an other binding obligation gives rise to a liability the availability of funding to settle the obligation may be a persuasive indicator.

Sovereign Power to Avoid Obligations

- BC37. 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.

Commitments

Staff comment: Paragraph BC 38 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.

BC38. 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

Staff comment: Section 4 has been updated to acknowledge responses to CF-ED2 and reflect the decision to adopt the Option D approach to the identification of the elements.

- BC39. CF-CP2 explained that one approach to defining revenue and expenses is to take the view that these elements can be derived from changes in assets and liabilities. It 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. CF-CP2 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.
- BC40. CF-ED2 reflected a view that revenue and expenses should be defined to focus on the current year activities of the entity. It explained that, in precisely defined circumstances, certain inflows and outflows of resources would not meet the definition of revenue and expenses, but rather are deferred inflows and deferred outflows which should be identified as separate elements of the financial statements. CF-ED2 proposed that revenue and expenses should be defined to reflect the inflows of resources used to finance services and the outflows of resources related to providing those services in the reporting period. Consequently, revenues and expenses were defined as inflows and outflows of resources during the period that increased or decrease net assets other than deferred inflows, deferred outflows, ownership contributions and ownership distributions.
- BC41. As noted in paragraph BC3, a majority of respondents to CF-ED2 did not support the identification of deferred inflows and outflows as elements and the resultant definitions of revenue and expenses. However, some of those respondents acknowledged that the definitions of assets, liabilities, ownership contributions, and ownership distributions included in CF-ED and definitions of revenues and expenses derived from changes in assets and liabilities may not capture all the economic phenomena that should be reported in the financial statements or the notions of financial performance that may be useful to users.

- BC42. The IPSASB was persuaded by these arguments and has responded to the views of respondents. The Chapter does not identify deferred inflows and deferred outflows as elements, but acknowledges that IPSASs that deal with particular transactions or other events may require or allow some resources or obligations that do not satisfy the definition of an asset or a liability to be recognized in the financial statements when necessary to achieve the objectives of financial reporting. Consequently, the definitions of revenue and expenses have been revised to encompass transactions and other events that change net financial position, rather than net assets — because in certain circumstances specified by IPSASs, resources and obligations other than assets and liabilities may be recognized in the financial statements.
- BC43. The IPSASB is of the view that the concepts applicable to financial reporting, and the notions of financial performance and financial position to be reflected in financial statements will continue to evolve over time in the light of the experience of preparers, users and standard setters. As noted in the Preface, this Conceptual Framework is to be viewed as a living document. Consequently, the identification of elements of financial statements as identified in this document may be developed further in the future.

Staff comment: The Preface to the Conceptual Framework does not currently acknowledge that the Framework is a living document. However, staff is of the view that if Option D is adopted it would be appropriate to include such an observation in the Preface.

Revenue

- BC44. The IPSASB considered whether the definition of revenue should be the “net” or “gross” increase in “net” financial position. 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.
- BC45. 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
- BC46. 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

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

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.

- BC47. As discussed in more detail in BC51-BC53, 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: Other resources or obligations

Staff comment: Section 5 has been updated to acknowledge responses to CF-ED2 and outline the matters and approaches explored by the IPSASB as it moved to its final decision on the elements.

It has also been updated to respond to the IPSASB direction at its September 2013 meeting that 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.

- BC48. Responses to CF-CP2 and CF-ED2 indicate that measures of financial performance that reflect (a) changes in net assets or net financial position during the reporting period; and (b) the inflows and outflows of flows of resources that relate to the activities of the current period, are both seen as relevant and useful to users of GPFs. In responding to the views of respondents, the IPSASB considered whether the Conceptual Framework should simply identify the characteristics of the elements and provide guidance on how these elements may be assembled to present information about each of these measures of financial performance. The composition and type of the financial statements that would be used to present the elements, and the measures of performance that they were to reflect, would then be specified at standards level, and may evolve over time and be influenced and enhanced by jurisdictional considerations. However, as noted in paragraph BC4, the IPSASB concluded that while such an approach had merit, the Conceptual Framework should provide clear direction on the elements that were to be recognised in the statement of financial position and statement of financial performance
- BC49. In developing this Chapter of the Conceptual Framework the IPSASB considered a number of potential approaches to identifying the elements of financial statements that would best achieve the objectives of financial reporting and respond to the concerns and views of respondents to CF-CP2 and CF-ED2 and those that provided input at other forums and components of the IPSASB's consultative process. These approaches are outlined below. The IPSASB acknowledges that each approach has strengths but also some shortcomings. The IPSASB is of the view that the approach reflected in this Chapter is one that allows relevant measures of performance to be presented in GFRSs, best responds to the concerns of constituents and provides a mechanism for financial reporting to further evolve to respond to users information needs.

BC50. Approaches considered by the IPSASB and, in some cases explained in CF–CP2 and proposed for adoption in CF–ED2 include:

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

BC51. The IPSASB considered that broadening the definition of an asset and liability distorts the essence of these elements, because it may for example lead to identifying as assets resources that an entity does not, in substance, control and identifying as liabilities obligations that are not present obligations. Such an approach would not be transparent or easily understandable to many users and may conflict with other QCs including relevance and 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.

BC52. Presentational approaches can be used to provide information about period flows as well as changes in the resources available to support the provision of services in future periods and claims to those resources. A number of respondents to CF–ED2 noted that presenting information about inflows and outflows of resources that relate to the present and/or future periods through note disclosure is not a substitute for their recognition.

BC53. Some constituents expressed the view that approaches that define revenue and expenses by reference to changes in assets and liabilities exclude the possibility that in some, albeit rare, circumstances, resources and obligations that arise from some transaction or other events and do not satisfy the definition of any of the elements may need to be recognized to enable the financial statements to provide information useful for accountability and decision purposes. They argue that these circumstances can and do arise and, in the absence of any allowance for their separate recognition such resources and obligations are tenuously or erroneously classified as one of the defined elements, with deleterious effects on transparency and assessments of financial performance and financial position. Some of these constituents note that the Framework should simply acknowledge that this may occur and that it will be dealt with at standards level.

BC54. CF-ED2 proposed that Deferred Inflows and Deferred Outflows should be defined as separate elements of the statement of financial position, and provided detailed guidance on the circumstances in which they should be recognized. In the process of finalizing CF-ED2, the IPSASB considered whether deferred inflows and deferred outflows should be identified as elements of the statement of financial performance, and thus allow measures of both changes in net assets and period flows to be presented in that statement. However, the IPSASB rejected this approach because of concerns that it would require recycling of deferred inflows and outflows to

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

revenues and expenses in future periods, and this would unnecessarily complicate and undermine the understandability of the financial statements.

- BC55. As noted in paragraph BC3, while some respondents supported the approach proposed in CF-ED2 the majority of respondents did not support identifying DI and DO as elements. The IPSASB has responded to input from constituents. While the Conceptual Framework no longer identifies Deferred Inflows and Deferred Outflows as elements, the IPSASB remains of view that presentation of information about period flows is important and should be addressed through presentation.

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

Staff comment: Paragraphs BC 56 below has been updated to reflect the IPSASB's decision at its meeting in December 2013 to adopt Option D to the identification of the elements of the financial statements.

- BC56. Net assets is the difference between assets and liabilities. This Conceptual Framework acknowledges that IPSASs may in some circumstances require the recognition of resources or obligations other than those that satisfy the definition of an element in the statement of financial position. Net financial position is the aggregate of an entity's net assets and other resources and other obligations recognized in the statement of financial position at the reporting date. The IPSASB anticipates that for most public sector entities the amounts of net assets and net financial position will not differ, or not differ materially. In these cases, net assets/net financial position will represent the resources available for providing services in future periods and the claims against those resources. However, where resources and obligations other than those encompassed by the elements are recognized in the financial statements, the amounts reported as net assets and net financial position may differ. In these circumstances, the interpretation of net financial position and its relationship to net assets will be determined by reference to the nature of the additional resources and obligations recognized in the financial statements.
- BC57. The IPSASB considered whether net assets or, if appropriate, 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 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.
- BC58. 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 assets and net financial position are a residual amounts that should not be defined. Treating net financial position in such a way is more straightforward and understandable

Staff comment: The amendments to the final sentence of paragraph BC59 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.

BC59. However, the IPSASB acknowledged that part of net assets or 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 assets or 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 the Definition of the Elements

BC60. The IPSASB considered whether all recognition criteria should be integrated in definitions of the elements. The IPSASB acknowledged the view that the inclusion of recognition criteria in definitions of the elements enables preparers to consider all the factors that must be taken into account in evaluating whether an item of information is recognized as an element in the financial statements. However, the IPSASB took the view that while there is overlap in factors to be considered in determining whether an item satisfies the definition of an element and whether that element qualifies for recognition, particularly in respect of whether the recognition criteria of existence uncertainty is met, recognition should be considered as a distinct stage in the financial reporting process. This is because recognition embraces consideration of factors broader than whether the definition of an element is satisfied and may apply to the recognition of items that do not satisfy the definition of an element. 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: For the most part amendments to paragraphs BC60 to BC67 are proposed to acknowledge the overlap of recognition and definition of the elements.

The addition of the final sentence of paragraph BC64 was agreed by the IPSASB at its meeting in September 2013. Other amendments to paragraph BC 64 are proposed to focus on reservations about the threshold approach and to acknowledge that similar risks may also arise under other approaches to recognition, but that an approach based on an assessment of all available evidence is more likely to satisfy the QCs.

BC61. In determining whether an element should be recognized there are two types of uncertainty that need to be considered. The first is existence uncertainty—matters that will have been considered in determining 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

BC62. The IPSASB 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.

BC63. 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.

BC64. The IPSASB formed a view that the adoption of thresholds for recognition purposes risks omitting information that is relevant and faithfully representative and may 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 acknowledges that such risks can also exist for approaches which do not specify thresholds for recognition. This is because preparers will make their own assessments of the circumstances or "the threshold" that justifies recognition and those assessments can change for different items and over time. However, the IPSASB concluded that, on balance, an approach that is based on an assessment of all available evidence in determining whether an element exists and takes account of uncertainty about the flows of service potential or economic benefits in measurement is a more appropriate response to the uncertainty faced by preparers of financial statements. It is more likely to result in the recognition of information that satisfies the QCs than is the establishment of an arbitrary threshold that must be adhered to. 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.

- BC65. 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.
- BC66. 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 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. As noted in paragraph BC60 these matters will also have been considered in determining whether an item satisfies the definition of an element.
- BC67. 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 BC68 was approved at the September 2013 meeting. It is presented in mark-up here to allow Members to identify changes to CF-ED2. Amendments to BC69 have been made to acknowledge responses to CF-ED2

Measurement Uncertainty

- BC68. 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

- BC69. The IPSASB considered the view that different criteria should be used for initial recognition and derecognition. 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.

ATTACHMENT: ALTERNATIVE VIEWS AND IASB and GFS APPENDICES INCLUDED IN CF—ED2.

Alternative Views

Staff comment: The following paragraphs identifying Alternative Views and the appendices identifying differences from IASB and GFS approaches will not be included in the final Chapter, consistent with the IPSASB's decisions on the form and content of the Conceptual Framework.

They are included here as an Attachment to allow Members to refer to them if useful.

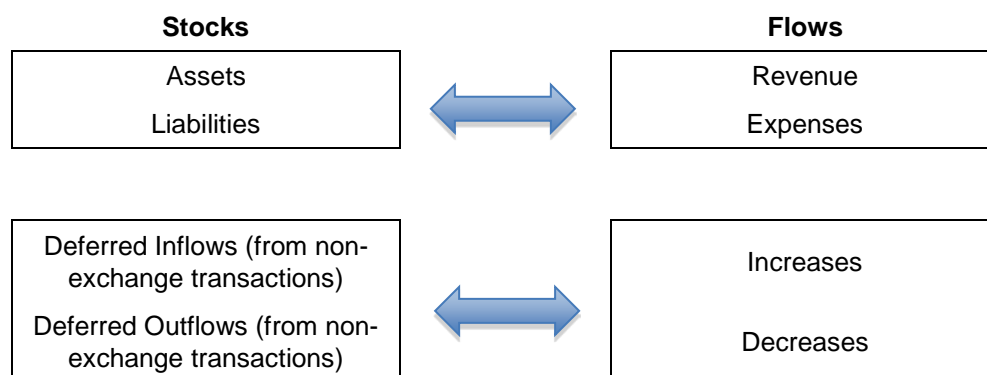
Alternative View of Prof. Mariano D'Amore

- 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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Draft Minutes of December 2013 Meeting*Deferred Inflows and Deferred Outflows*

The Chair asked the IPSASB to consider a proposal by the Phase 2: Task Based Group (TBG) that the IPSASB adopt Approach E, a hybrid approach that included components of the four options identified by Staff in the Issues Paper at Agenda Item 6B.1. In order to support this approach staff had circulated the slide deck prior to the agenda item.

Mr. Ian Carruthers highlighted the main features of Approach E. Mr. Carruthers noted that this approach was not the optimal solution of individual members of the TBG, but that, in the view of the TBG, it represented a viable way forward on the most difficult issue in Phase 2 of the project. Approach E would allow reporting of inflows and outflows that provide service potential or economic benefits, but do not affect assets and liabilities as defined in the Framework and the reporting of inflows and outflows that do not affect revenue and expenses [is this repeating first part of sentence?]. It would not explicitly define deferred inflows and deferred outflows. The main issue under this approach was whether to define such inflows and outflows as elements. On balance the TBG did not favor defining such inflows and outflows as elements, because of the difficulties inherent in developing definitions. Another member of the TBG said that the approach reflected the current development of conceptual thinking, accepting that there are economic phenomena that do not meet the six defined elements and such an approach would allow for further developments to be made a standards level.

Members raised a number of issues particularly related to the relationship of inflows and outflows and assets and liabilities and revenue and expenses. Members also expressed some uncertainty as to how Approach E differed from Approach D. TBG members explained that the approach had a number of similarities to Approach D but that, unlike Approach D, it focused on resources and obligations.

Some reservations were also expressed that Approach E might give preparers too much discretion to identify economic phenomena not meeting the definitions of elements for presentation in the financial statements. Therefore it might be necessary for the Framework to include an explicit assertion that such economic phenomena would only be identified by the IPSASB at standards level.

Some members considered that Approach E introduced some interesting ideas, but there was a general view that it was insufficiently developed. The IPSASB rejected Approach E largely because of this lack of detail, its complexity, and the fact that it was not discussed in the Issues Paper.

The Chair then directed staff to summarize concisely each of the four options in the Issues Paper:

- 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.

For each option staff listed the main advantages claimed by its supporters and the main disadvantages put forward by those who opposed it. Staff also indicated the main changes that would need to be made to CF-ED2 if a particular option were to be adopted.

Staff explained that Option A differed from the approach in CF–ED2 because the definitions of deferred inflows and deferred outflows would not be restricted to non-exchange transactions and would not require that the flows should be related to a specified future period.

The main advantages claimed for Option A are:

- Provides a principled approach that meets the objectives of financial reporting and the qualitative characteristics;
- Facilitates assessments of operational capacity and the cost of services;
- Allows on-going development of to better achieve objectives and QCs;
- Provides more faithfully representative, relevant, understandable and comparable information on cost of services;
- Does not involve recycling from residual amount to surplus/deficit; and
- Does not require modifications of asset and liability definitions.

The main disadvantages put forward by opponents of Option A are:

- Deferred inflows and deferred outflows are not separate economic phenomena;
- Inflows should be recognized as revenue if the entity controls the resource, the inflow is not an ownership contribution and there is no related present obligation;
- Outflows should be recognized as expenses if the entity has no further control of the resource; and
- It leaves decisions on the use of these elements to the standards level with insufficient conceptual guidance

If Option A were to be adopted the main changes to CF–ED2 would be:

1. The links from elements to specific financial statements in section 1 would be removed;
2. Explanation would be added that statements for recognition and presentation of the elements would be developed at standards level and as existing IPSASs are reviewed following issue of the Framework;
3. Revised definitions of DI and DO would be developed with supporting explanation; and
4. The Basis for Conclusions would be modified.

Staff was asked whether the term “net financial position” would be retained if Option A were adopted. Staff said that under Option A there would be no attribution of elements to particular financial statements, so the term “net financial position” and formula for determining it would not be retained.

Under Option B deferred inflows and deferred outflows would not be defined as elements but treated as revenue and expenses. Option B would deal with deferred flows through a combination of display on the face of the financial statements and disclosure through notes. There were two variants of this option. In the first variant deferred flows would be taken directly to surplus/deficit, while in the second variant deferred flows would initially be taken to residual amount and then recycled to surplus/deficit in the period that time stipulations occur.

Staff expressed a view that both these variants were consistent with the Alternative View (AV) of Ms. Jeanine Poggiolini in CF–ED2. Ms. Poggiolini disagreed with this view, because her AV did not envisage recycling, which was a key feature of the second variant. Staff apologized for this misrepresentation.

The main advantages claimed for Option B were:

- It demonstrates the resources for which an entity is accountable and claims on those resources at the reporting date;
- It is based on transaction-neutral principles;
- It uses globally accepted definitions of an asset and a liability that do not include deferred debits and deferred credits and definitions of revenue and expenses that are based on movements of assets and liabilities in the reporting period;
- It is based on a principle that “the passage of time” is not a sound reason for delaying recognition of flows that otherwise meet the definitions of revenue and expenses;
- Variant 1 can satisfy information needs through presentation; and
- Variant 2 achieves the same outcome as Options A & C, but without distorting the elements.

The main disadvantages put forward by opponents of Option B are:

- Variant 1 may not produce information that is representationally faithful of an entity’s sustainable performance and therefore does not meet the objectives of financial reporting; and
- Variant 2: involves recycling and introduces the IASB’s notion of Other Comprehensive Income into the Framework by another name.

If Option B were to be adopted the main changes to CF–ED2 would be:

1. The definitions of DI and DO and accompanying narrative in Section 5 would be deleted;
2. The definitions of revenue and expense and accompanying narrative in Section 4 would be modified;
3. The term net financial position and accompanying discussion in Section 1 would be deleted; and
4. The Basis for Conclusions would be modified.

Under Option C the definitions of an asset and a liability would be modified to include references to ‘certain deferred credits/debits’ (or similar terminology) rather than defining additional elements. Staff noted that such an approach had been explored, but not fully developed, in the early 1970s in the United States. Staff said that a criticism at that time was that the approach allowed virtually any phenomena to meet the definition of an asset or a liability.

The main advantages claimed for Option C are:

- It does not require the development of separate elements for deferred flows;
- Revenue & expenses are determined by movements in assets and liabilities apart from ownership contributions and ownership distributions; and
- It allows the standard setter to respond to particular circumstances appropriately.

The main disadvantages put forward by opponents of Option C are:

- Distorts the asset and liability elements because the:
 - Asset definition includes resources that an entity does not control; and
 - Liability definition includes obligations that are not present obligations; and
- Allows the standard setter to determine what is a deferred credit or deferred debit on an ad hoc basis which diminishes accountability.

Staff noted that the IPSASB had provided its reasons for rejecting Option C in the Basis for Conclusions in paragraph BC44 of CF–ED2.

If Option C were to be adopted the main changes to CF–ED2 would be:

1. The definitions of an asset and a liability would need to be amended to include references to deferred debits and deferred credits (or similar terms);
2. The definitions of DI and DO and accompanying narrative in Section 5 would be deleted;
3. Supporting narrative would be added to Sections 2 and 3 to explain that the definitions of an asset and a liability includes deferred debits (outflows) and deferred credits (inflows);
4. The definitions of revenue and expenses would be modified so that they are based on movements in assets and liabilities. The narrative in Section 4 would also be changed; and.
5. The Basis for Conclusions would be modified.

Under Option D, six elements would be defined: an asset, a liability, revenue, expenses, ownership contributions and ownership distribution. As in Options B and C, DI and DO would not be defined as elements under Option D. It would be acknowledged that there are other economic phenomena that do not meet the definition of elements. Certain such phenomena might need to be presented in the financial statement in order to meet the objectives of financial reporting. Other economic phenomena might be presented in general purpose financial reports (GPFRs) outside the financial statements or might be outside the scope of GPFRs.

The main advantages claimed for Option D are:

- Is transparent in acknowledging the current position reached by conceptual thinking;
- Avoids “shoehorning” (forcing) transactions/events into existing elements;
- Avoids defining additional elements at this time, while acknowledging that additional elements might be necessary in the future; and
- Does not require modification of the asset and liability definitions, unlike Option C.

In explaining the point about “shoehorning” Staff discussed an accounting treatment in IPSAS 32, *Service Concession Arrangements*, a number of members and commentators had expressed reservations whether the provision by a grantor of a right to an operator of a service concession asset to charge users of the asset was a liability of the grantor. This was based on a view that the granting of such a right did not involve a sacrifice of resources by the grantor. Option D would allow such a transaction to be treated as another economic phenomenon rather than a liability.

The main disadvantages put forward by opponents of Option C are;

- Unlike Option A it is not transparent and can lead to transactions/events being presented as assets and liabilities when they do not meet the definitions of those elements;
- It is inappropriate to define elements but then state that they do not encompass certain transactions and events;
- It diminishes accountability by allowing avoidance of the use of defined elements on ad hoc basis;
- The impact on the definitions of revenue and expenses is unclear: are these definitions based on movements in assets or liabilities? and
- It provides inadequate guidance for the standard setter.

If Option C were to be adopted the main changes to CF–ED2 would be:

1. The definitions of DI & DO and narrative in Section 5 would be deleted;
2. Section 1 would be modified to explain the nature of other economic phenomena;
3. The definitions of revenue and expenses and, the notion of net assets might need modification and an explanation of how the recognition criteria relate to other economic phenomena would have to be developed; and
4. The Basis for Conclusions would be modified.

Following discussion and a process of informal voting members eliminated Options C and B. In a final round of informal voting members decided to adopt Option D. Some members emphasized that their support of Option D was contingent on the development of more detailed explanation. Members directed the staff and the TBG to further develop Option D for the next meeting, in particular focusing on the impact of the option on the definitions of an asset, a liability, revenue and expenses and approaches to surplus/deficit and financial performance.

Definitions of an Asset and a Liability

The IPSASB accepted a Staff View that the definitions of an asset and a liability should be modified, so that they read more elegantly. The amended definitions had not changed substantively. The revised definitions are:

- An asset is a resource that an entity presently controls as result of a past event; and
- A liability is a present obligation of an entity for an outflow of resources that results from a past event.

Definitions of Ownership Distributions and Ownership Contributions

The IPSASB agreed with the staff view that the phrase “in their capacity as owners” should be inserted into the definition of “ownership distributions” and also, directed that, contrary to the staff view, it should

be included in the definition of “ownership contributions”. The revised draft definitions of these two elements are:

- 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; and
- Ownership contributions are inflows of resources to an entity, contributed by external parties in their capacity as owners that establish or increase an interest in the net assets of the entity.

Recognition

Staff put forward a view that the approach to recognition in Section 7 of the draft final chapter is flawed. Staff noted that, as currently drafted, existence uncertainty deals with all components of the definition of an asset and a liability. Staff held the view that if there is uncertainty about whether an entity controls a resource at the reporting date or whether a past event has occurred, such uncertainty would be addressed in determining whether the transaction or event meets the definition of an asset. Similarly, if there is doubt whether an obligation is a present obligation of an entity for an outflow of resources or whether a past event has occurred this would have been assessed in deciding whether the obligation meets the definition of a liability.

Staff therefore expressed a view that the primary focus of the recognition criteria discussed in paragraphs 7.3 and 7.4 should be limited to uncertainty about the existence of inflows of service potential or economic benefits to the entity and outflows of service potential or economic benefits from the entity. Uncertainty about the other components of the definition would be addressed when assessing whether a transaction or event met the element definition. Staff also had strong reservations whether the assertion that recognition is a distinct stage in the financial reporting process in paragraph BC54 of the Basis for Conclusions is valid. Staff further expressed a view that the core text in the Framework was inconsistent with the point in paragraph BC 55 that existence uncertainty is “whether an item meets the definition of an element.”

Members accepted that the discussion of existence uncertainty in paragraphs 7.3 and 7.4 should be refined. However, members did not accept the staff view that existence uncertainty should be limited to uncertainty about inflows and outflows of service potential.

It was agreed to relocate paragraph 7.2, which establishes a principle that 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. This paragraph would be positioned after the paragraph on measurement uncertainty.

Minutes of September 2013 Meeting

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 Chair 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.