

Meeting: International Public Sector Accounting
Standards Board

Meeting Location: Brussels, Belgium

Meeting Date: September 15-18, 2014

Agenda Item 2B

For:

☒ Approval

☒ Discussion

☐ Information

Conceptual Framework: Elements and Recognition in Financial Statements

Objective(s) of Agenda Item

1. The objectives of the session are:

- (a) To **consider** the Issues Paper on the further drafts of Chapter 5, *Elements in Financial Statements*, and Chapter 6, *Recognition in Financial Statements*, and **provide** directions on those issues;
- (b) To **review** further drafts of the final chapters and **provide** directions for revision; and
- (c) To approve Chapters 5 and 6.

Material(s) Presented

Agenda Item 2B.1	Issues Paper on Further Drafts of Chapter 5, <i>Elements in Financial Statements</i> and Chapter 6, <i>Recognition in Financial Statements</i>
Agenda Item 2B.2A	Marked-Up Draft of Chapter 5
Agenda Item 2B.2B	Clean Draft of Chapter 5
Agenda Item 2B.3A	Marked-Up Draft of Chapter 6
Agenda Item 2B.3B	Clean Draft of Chapter 6
Agenda Item 2B.4	Draft Minutes June 2014 Meeting

CONCEPTUAL FRAMEWORK: ISSUES PAPER ON FURTHER DRAFT OF CHAPTER 5, ELEMENTS IN FINANCIAL STATEMENTS AND CHAPTER 6, RECOGNITION IN FINANCIAL STATEMENTS

Objectives of Issues Paper

1. This aim of this Issues Paper is to highlight key issues in the further drafts of Chapter 5, *Elements in Financial Statements*, and Chapter 6, *Recognition in Financial Statements*.

Structure of Issues Paper, Key Issues Addressed and Approach to Agenda Session

2. The Issues Paper includes a brief background section. The paper then addresses four issues on which Staff explains the approach taken following discussion with the Phase 2 Task Based Group (TBG). Following discussion of these issues Staff proposes that the IPSASB carries out a page-by-page review of the marked-up draft final chapters at Agenda Item 2B.2A and 2B.3A. Clean versions of the draft final chapters are provided at Agenda Items 2B.2B and 2B.2C. These clean versions provide a better perspective on the overall flow of the chapters. Following the page-by-page review Staff highlight the issue of re-exposure. In accordance with due process, detailed discussion of, and decisions on re-exposure, will be carried out after the approval of Chapter 5.

Background

3. The most significant changes from the June 2014 version(s) and the reasons for change are summarized in staff comment boxes throughout the revised versions at Agenda Items 2B.2A and 2B.3A (and 2B.2B and 2B.3B). These include implementation of the decisions:
 - In Section 3, *Liabilities* to distinguish present obligations and obligations that are not present obligations; and
 - To provide recognition criteria.

Before commencing a page-by-page review of the final chapter there are four issues for discussion.

Key Issues Addressed in this Paper

4. This section of the paper addresses:
 - Linkage of Elements to Particular Financial Statements
 - Distinguishing a Present Obligation and Obligations that are not Present Obligations
 - Definition of Revenue AND Usage of Expense
 - Title of Section 5
 - Recognition Criteria

Linkage of Elements to Particular Financial Statements,

5. The version of Chapter 5 for the June meeting included linkages between the elements and particular financial statements. The TBG considers that these linkages are made, where appropriate, elsewhere in the Chapter and that this level of detail is unnecessary in the Introduction.

Matter(s) for Consideration

1. The IPSASB is requested to **confirm** the changes to the revised Section 1. If not the IPSASB is asked to **provide** directions for revision.

Distinguishing a Present Obligation and Obligations that are not Present Obligations

6. In Section 3 an explanation has been introduced to distinguish a present obligation from other obligations that a public sector may enter into. The explanation states that the distinguishing feature of a present obligation is that an entity has little or no realistic alternative to avoid the obligation.

Matter(s) for Consideration

2. The IPSASB is requested to **confirm** the explanation in Section 3 of the distinction between a present obligation and other obligations? If not, the IPSASB is asked to **provide** directions for revision.

Definition of Revenue & Usage of Expense

7. The revised draft definition of revenue in Section 5 is:

Increases in the net financial position of the entity, other than increases arising from ownership contributions.

8. The revised definition of revenue does not state whether the increase in net financial position is “gross” or “net”. A gross approach might not be appropriate 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 and the carrying amount to be recognized as an expense, rather than the difference between the disposal proceeds and the carrying amount. Conversely, presentation of the “net” position on the face of the financial statements might be similarly inappropriate in circumstances such as the sale of inventory in non-exchange transactions as it would not provide information on the proceeds of sale of the inventory. The TBG came to a view that the Framework should be neutral on this issue. The decision on whether the increase in net financial position represented by revenue is gross or net should be determined at standards level dependent on which treatment better meets the objectives of financial reporting. This is explained in paragraph BC60 of the Basis for Conclusions.
9. The singular “expense” been used rather than the plural “expenses”. There has been some confusion over which usage has been agreed and Staff requests that the IPSASB confirms the usage of expense. Staff notes that the International Accounting Standards Board uses the singular in its Framework project.

Matter(s) for Consideration

3. The IPSASB is requested to **confirm**:

- The revised definition of revenue in Section 5 and the explanation in paragraph BC60 why the definition of revenue does not specify whether the increase in net financial position is gross or net? If not, which what amendments should be made to the definition and supporting material in the Basis for Conclusions?; and
- The usage of the singular “expense”.

Title of Section 4 of the Final Chapter

10. At the June 2014 meeting the IPSASB directed that the title of Section 4 should be shortened to *Net Financial Position* rather than *Other Resources, Other Obligations and Net Financial Position*. Members of the TBG have challenged this change, because in their view this would restrict the recognition of other resources and other obligations to “stocks” in the statement of financial position rather than flows in the statement of financial performance. In the view of these TBG members this change would fetter the discretion of the IPSASB in future standard setting. The TBG therefore considers that the title in the June version should be retained.

Matter(s) for Consideration

4. The IPSASB is requested to **confirm** that the title of Section 4 should be *Other Resources, Other Obligations and Net Financial Position*, or **provide** alternative directions.

Recognition Criteria in Chapter 6

11. The IPSASB directed that recognition criteria should be developed and included in Chapter 6, *Recognition in Financial Statements*. The recognition criteria are provided in paragraph 1:
- The definition of an element has been satisfied and the element exists; and
 - The element can be measured in a way that satisfies the Qualitative Characteristics (QCs).

Matter(s) for Consideration

5. The IPSASB is asked to **confirm** the recognition criteria in Chapter 6, or **provide** alternative recognition criteria.

Re-exposure of Chapter 5

12. Staff is aware that some Members have raised the question of whether Chapter 5 needs to be re-exposed. As indicated in the Issues Paper for the June meeting, under the IPSASB's due process consideration of the re-exposure of Chapter 5 will take place after the final revised content of the Chapter has been approved. An affirmative vote that re-exposure is necessary is required to issue a re-exposure draft. Under the IPSASB's terms of reference this would require that two-thirds or more of Members (i.e., 13 or more Members) support re-exposure. If two-thirds of Members do not vote in favor of re-exposure, the final Chapter 5 would be issued as approved. It should be noted that it is a matter of the Board's judgment as to whether re-exposure is necessary.

13. The due process and working procedures provide the following guidance on re-exposure:

“Situations that constitute potential grounds for a decision to re-expose may include, for example: substantial change to a proposal arising from matters not aired in the exposure draft such that commentators have not had an opportunity to make their views known to the PIAC¹ before it reaches a final conclusion; substantial change arising from matters not previously deliberated by the PIAC; or substantial change to the substance of a proposed international pronouncement. “ (A42 “Due Process and Working Procedures” document).
14. Exposure Draft, *Conceptual Framework: Elements and Recognition in Financial Statements* (CF-ED2) proposed definitions of deferred inflows (DIs) and deferred outflows (DOs) as elements. These proposed elements were restricted to non-exchange transactions that contained specific time stipulations. The final Chapter does not include DIs and DOs as elements, but acknowledges that “other economic phenomena” might need to be recognized in order to meet the objectives of financial reporting. In subsequent sections of Chapter 5 “other economic phenomena” are referred to as “other resources and other obligations”. The current position is a change from the proposal to define DIs and DOs as elements in CF-ED2.
15. In reviewing the guidance on re-exposure, the main consideration is that the position in the final Chapter is “a substantial change to the substance of a proposed international pronouncement”. Section 4 of the Chapter gives the IPSASB broad discretion to determine that items that do not meet the definition of the elements defined in the Chapter should be recognized in the financial statements. The question is whether constituents should be asked to provide views on such a change from the proposals in CF-ED2.
16. The main questions related to re-exposure is whether any new insights are likely to be provided and whether the costs to both constituents in responding to a further consultation and to the IPSASB in analyzing those responses justify the benefits. The IPSASB has consulted on the issues twice to date – in CF-ED2 and previously in the Consultation Paper, *Elements and Recognition in Financial Statements* (CF-CP2). Staff highlight that the consultation to CF-ED2 elicited few views that had not previously been expressed in response to CF-CP2, apart from criticisms of the proposed definitions of DIs and DOs. Staff does not think that a further consultation will elicit any new insights from those already expressed in responses to CF-CP2 and CF-ED2.
17. Paragraphs BC 36-BC56 summarize the development of the IPSASB’s conceptual thinking on models of financial performance and deferred flows from the discussion in CF-CP2 to the current drafting of Section 4 in Chapter 5. In particular the Basis for Conclusions discusses the five options for dealing with deferred flows considered by the IPSASB at the December 2013 meeting.
18. The options the IPSASB considered are comprehensive and, as noted previously, staff considers that a further consultation is unlikely to provide any new insights not expressed previously.

Staff View

19. On balance Staff does not support re-exposure. Staff does not expect that new arguments would be presented that would change the IPSASB’s decisions on this issue as reflected in the proposed revised Section 4. Staff therefore does not believe that the benefits of re-exposure would be commensurate with the costs in terms of new insights that may be gained on the issues. Staff also notes that there is

¹ A PIAC is a Public Interest Activity Committee

a potential risk of re-opening other issues on which the Board and constituents generally agree if there is partial re-exposure.

Matter(s) for Consideration

6. The IPSASB is asked whether it **agrees** with the Staff conclusion that Chapter 5 should not be re-exposed.

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

TABLE OF CONTENTS TO BE UPDATED IN INTEGRATED FRAMEWORK.

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1. Introduction

Staff Comment: The direction at the June meeting was that linkages between the elements and particular should be “softened”, TBG was not supportive of Staff’s attempts to achieve this, which TBG found ambiguous. TBG’s view is that linkage with the financial statements is covered elsewhere in the chapter and that the references to particular statements in paragraph 1.2 are unnecessary. They have therefore been deleted.

Footnotes 1 and 2 have been deleted as it is unnecessary to include detail on material in Chapters 2 and 3 in the finalized version.

Both the narrative description and formula for net financial position have been deleted and a cross-reference to section 4 inserted in accordance with directions at the June meeting.

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.

Elements and their Importance

- 1.2 Financial statements portray the financial effects of transactions and other events by grouping them into broad classes which share common economic characteristics. These broad classes are termed the elements of financial statements. Elements are the building blocks from which financial statements are constructed. These building blocks provide an initial point for recording, classifying and aggregating economic data and activity in a way that provides users with information that meets the objectives of financial reporting⁴ and ~~contributes to-satisfies~~ the qualitative characteristics (QCs) of financial reporting ~~and the constraints on information included in GPFRs.~~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~~ do not refer to the individual items ~~themselves that are recognized as a result of transactions and events.~~ 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 ~~8.7~~ 8.7 *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

⁴ ~~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.~~

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.

Elements Defined and Approach to Recognition

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 financial position is represented by:~~

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

~~1.71.6 Net financial position is defined, but it is not an element. Section 4 discusses net financial position in more detail. Net financial position is determined by amounts of assets, liabilities, other resources and other obligations. Net financial position is discussed in section 4.~~

2. Assets

Staff Comment: The definition of an asset has been modified to better align with IASB definition in accordance with directions at the June meeting. However, at the June meeting the IPSASB decided not to replace “past event” with “past events”.

Definition

2.1 An asset is a resource ~~that an entity~~ presently ~~control~~controlled by the entitys as a result of a past event.

A Resource

Staff Comment: The direction at the June meeting was to use the more concise phrase “capable of providing service potential” in the description of a resource. However, because the description of service potential includes “capacity to provide services” it is unnecessary to use the phrases “capable of” or “ability to” in the description of a resource in paragraph 2.2. This also applies to economic benefits~~...~~

“Necessarily” has been reinserted in paragraph 2.3 in accordance with direction at June meeting, as some assets primarily held for service delivery do generate cash flows.

A reference to cash has been reinserted in paragraph 2.5 and the explanation of economic benefits slightly modified.

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 item~~ itself or from the rights to use 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; or
- (e) Receive a stream of cash flows.

2.3 Service potential is the capacity ~~of~~ 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 which are used to 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*) many assets that embody service potential are specialized in nature.

2.5 Economic benefits are the ability to provide ~~take the form of~~ cash inflows or a reduction in cash outflows. Cash inflows (or reduced cash outflows) may be derived from ... for example:

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

- (a) An asset's use in the production and sale of services; or
- (b) The direct exchange of an asset for cash or other resources;

In addition, a resource, such as cash, may be used-held to settle a liability or to make an ownership distribution.

An Entity Controls Presently Controlled by the Entity

Staff Comments: The title has been changed as a consequential to changes in the definition. In paragraph 2.8 the assertion that identification of the past event is straightforward for exchange transactions has been deleted in accordance with the direction at the June meeting. The penultimate sentence has been amended to focus actively on past event giving rise to a resource, rather than the obligation of external party. There has been significant further redrafting of paragraph 2.8.

- 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 presently 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.

Past Event

- 2.8 The definition of an asset requires that a resource that an entity presently controls must have arisen from a past transaction or other past event. ~~an asset arises from a past transaction or other event. The past transactions or other events that result in an entity gaining control of a resource and therefore an asset may differ. There are a number of potential points at which such events may occur. It is essential to determine the point or event at which transactions, rights or powers give rise to an asset of the entity.~~ Entities can obtain assets by purchasing them in an exchange transaction or producing-developing them. ~~In such cases, identification of the past transaction or other event is straightforward.~~ Assets may also arise through non-exchange transactions, including through the 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 public sector-specific powers and rights that may give rise to assets. For an entity to receive resources ~~Taking-In~~ the form of taxes ~~example of a tax~~, the following points in the process ~~may events 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~~the right to receive resources from an external party. When the power is exercised and the rights exist to receive resources, an asset arises.

3. Liabilities

Staff comment: A very minor change has been made to the definition to align with the current draft IASB definition. However, the IPSASB decided not to adopt the IASB's term "transfer (an economic resource)" because of the connotations of "transfer" in the public sector in relations to transfers between different levels of government and social benefits.

The IPSASB directed that "binding" should be added as a suffix to "legal" in legal obligation. TBG proposes the term "legally binding obligation" is used on first reference on grounds that this is consistent with the term "non-legally binding". On subsequent usage the more readable term legal obligation is used.

In paragraph 3.2 staff has added text to distinguish present obligations and other obligations.

Paragraph 3.4 has been redrafted.

In paragraph 3.13 (c) the presumption that where both (i) a budget line item has been approved and (ii) linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, has been removed.

Paragraph 3.6 on economic coercion and political necessity has been relocated to paragraph 3.13, as it is more appropriate to include it in the section on non-legally binding obligations.

Definition

- 3.1 A liability is a present obligation of ~~the~~^{an} entity for an outflow of resources that results from a past event.

A Present Obligation

- 3.2 Obligations are acts or courses of action which an entity is bound take. A present obligation is a legally binding (legal obligation) or ~~other binding requirement~~^{non-legally} binding obligation which an entity has little or no realistic alternative to avoid. Public sector entities can have a number of obligations. However, these ~~commitments and~~ obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid the obligation.

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~~^{for it to be settled}. An obligation that can be settled without an outflow of resources from the entity is not a liability.

Past Event

- 3.4 The complexity of public sector programs and activities means that ~~there are~~ a number of ~~potential commitments may be made and a number points of obligations may arise~~ in the development, implementation and operation of a particular program. For financial reporting purposes it is necessary to determine whether such commitments and obligations, including at which a present obligation may arise. This is particularly the case for binding requirements obligations that the entity has little or no realistic alternative to avoid but are not legally enforceable (referred to as "non-legally binding obligations" in this Conceptual Framework) are present obligations and satisfy the definition of a liability. To satisfy the definition of a liability, it is necessary that a present obligation arises as a result

of a past transaction or other event and requires an outflow of resources from the entity. Where an arrangement has a legal form and is binding, such as a contract, ~~thea~~ past event may be straightforward to identify. In other cases, it may be more difficult to identify the past event and identification involves an assessmentanalysis of when an entity has little or no realistic alternative to avoid an outflow of resources from the entity. In making such an assessment an entity takes jurisdictional factors into account.

Little or No Realistic Alternative to Avoid

Legal_ and Non-Legally Binding Obligations

3.5 Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations 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 anthe external party 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 a liability to exist.

~~3.6 “Economic coercion”, “political necessity” or other circumstances may give rise to situations, where, although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may not have a realistic alternative but to incur such an outflow. Economic coercion, political necessity or other circumstances may, lead to a liability arising from a non-legally binding obligation (see paragraphs 3.11–3.13).~~

~~3.7~~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 obligation involves an outflow of resources and gives rise to a liability. 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

~~3.8~~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 enter intohave 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 law⁴. 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.

~~3.9~~3.8 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

⁴ References to obligations enforceable in law encompass legal obligations and binding obligations subject to alternative processes with equivalent effect.

unconditionally enforceable subject to the passage of time are enforceable obligations in the context of the definition of a liability.

3.103.9 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 legal position should be assessed at each reporting date to consider if ~~it has changed and an obligation is no longer binding and does not meet the definition of a liability to determine whether a liability still exists.~~

Non-Legally Binding Obligations

3.113.10 Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give 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.

3.123.11 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).

3.133.12 These early stages of implementation are unlikely to give rise to present 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 Factors 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 ~~or may not~~ give rise to a non-legally 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 a non-legally 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 non-legally binding obligation may exist. However the absence of a budgetary provision is not, ~~of itself,~~ a reason for not recognizing an obligation that otherwise meets the definition of a liability liability and the recognition criteria.

3.13 "Economic coercion", "political necessity" or other circumstances may give rise to situations, where, although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to incur an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.

4. Other Resources and Other Obligations and Net Financial Position

Staff comment: Issues Paper discusses the title of this section Paragraph 4.1 has been deleted in accordance with directions at the June meeting. Staff thinks that the second sentence deleted from paragraph 4.3 is useful and should be retained.

Other Resources and Other Obligations

~~4.1 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 GPFs 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.~~

4.12 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 defined in this Conceptual Framework should be recognized 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 which are~~ items additional to the six elements defined in this Framework.

Net Financial Position

4.2 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.

~~4.3 As noted in paragraph 1.6, net financial position is not an element.~~

4.4 4.3 All items that meet the definition of assets and liabilities, and satisfy the recognition criteria set out in Chapter 6 are reported on the statement of financial position. ~~Except where an IPSAS requires or allows items that do not satisfy the definition of an asset or liability to be recognized in the statement of financial position as other resources or other obligations, net financial position is the difference between assets and liabilities.~~ Net financial position can be a positive or negative residual amount.

5. Revenue and Expense

Staff comments:

The definitions of revenue and expense are those agreed at the June meeting with the exception that the phrase “those arising from” have been added because ownership contributions and ownership distributions are not included in the calculation of net financial position. Two sentences have been added to paragraph 5.3 indicating that revenue and expense can arise through changes in previously recognized other resources and other obligations.

The Issues Paper discusses whether definitions should specify whether increases and decreases in net financial position are gross or net and reflects the view of the TBG that the Framework should be neutral on this issue

Staff has reservations about the reference to price changes, in paragraph 5.3, because (i) the treatment of price changes, is linked to concepts of capital and capital maintenance where the IPSASB has acknowledged in the Measurement phase that work needs to be carried out in future and (ii) given the linkage of revenue and expense to the statement of financial performance.

Other changes are editorials.

Definitions

5.1 Revenue is:

~~(a)~~ Increases in the net financial position of ~~the~~ entity, other than increases arising from ownership contributions; and

~~(b) — Reductions in amounts recognized as other obligations in previous reporting periods.~~

5.2 Expense ~~is~~:

~~(a)~~ Decreases in the net financial position of ~~the~~ entity, other than decreases arising from ownership distributions; and

~~(b) — Reductions in amounts recognized as other resources in previous periods.~~

5.3 Revenue and expense ~~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. Revenue can also arise through reductions in amounts recognized as other obligations in previous reporting periods. Expense can also arise through reductions in amounts recognized as other resources in previous reporting periods. They Revenue and expense may arise from individual transactions or groups of transactions.

Surplus or deficit for the Period

5.4 All items that meet the definition of revenues and expenses and the recognition criteria set out in Chapter 6 are reported on the statement of financial performance. The difference between revenue and expenses is the entity's surplus or deficit for the period. The entity's surplus or deficit for the period is the difference between revenue and expense reported on the statement of financial performance.

6. Ownership Contributions, and Ownership Distributions

Staff Comment: Following considerable discussion at the June meeting the definitions of ownership contributions and ownership distributions were retained. Staff expressed reservations that the current definitions may be flawed, because they suggest that there can be ownership interests in resources that an entity does not presently control as a result of a past transaction or other event and that ownership interests may be depleted by obligations that are not present obligations. TBG does not support Staff reservations and is comfortable with current wording, so it has been retained.

Definitions

- 6.1 Ownership contributions are inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity.
- 6.2 Ownership distributions are outflows of resources from the entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the net financial position of the entity.
- 6.3 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 ~~the payment of dividends~~ 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.
- 6.4 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.
- 6.5 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~~ those where an entity is restructured. ~~The return to owners may be either~~ Ownership distributions may be: a) a return on investment; b) a full or partial return of investment; or, c) in the event of the entity being wound up or restructured, a return of any residual resources.

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), which was issued in December 2010, 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 the~~ need to develop such elements in the future. ~~However, 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 and Financial Performance~~

Staff Comment: Material on the development of the IPSASB’s approach to “other economic phenomena” has been relocated to section 4: Net Financial Position. Paragraph BC3 has been inserted to acknowledge that there might be other elements of the financial statements.

~~Conceptual Framework Consultation Paper, Elements and Recognition in Financial Statements (CF–CP3)~~

~~BC2. CF–CP2 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)); 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.~~

~~BC3. 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 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.~~

~~BC4. 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 deferred inflows (DIs) and deferred outflows (DOs) as elements on the statement of financial position;~~

- ~~Broadening the asset and liability definitions to include items that are deferrals; or~~
- ~~Describing deferred flows as sub-classifications of net assets/net liabilities (subsequently referred to as the residual amount).~~

BC5. ~~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 their reasons. The second asked whether deferrals need to be identified on the statement of financial position. If respondents supported such identification on the statement of financial position they were asked to indicate which of the three approaches in paragraph BC4 they supported.~~

BC6. ~~The responses to these SMCs were inconclusive. 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.~~

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

BC7. ~~Following extensive discussions in the second half of 2011 and the first half of 2012 the IPSASB issued CF-ED2 in November 2012. 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 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.~~

BC8. ~~The two key features of these definitions were;~~

- ~~The proposed elements were restricted to non-exchange transactions; and~~
- ~~The flows had to be related to a specified future period.~~

BC9. ~~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.~~

BC10. ~~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.~~

BC11. ~~Most of the respondents to CF-ED2 disagreed with defining DIs and DOs as elements. Many 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.~~

~~BC12. The rationale for restricting the definitions to non-exchange transactions was challenged as conceptually weak both by respondents who favored defining DIs and DOs as elements and those opposed to these proposed elements. 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.~~

~~Finalizing the Elements Chapter~~

~~BC13. The IPSASB had to decide how to proceed in drafting the chapter on elements. 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 needs of users for information about flows relating to particular reporting periods.~~

~~BC14. The IPSASB therefore considered five options for the approach to be adopted in the Elements chapter:~~

- ~~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~~

~~BC15. The IPSASB concluded that it should adopt Option D. It considers that this option acknowledges that there may be circumstances under which the elements may not provide all information in the financial statements for meeting the needs of users and that it is transparent to accept that other items may be recognized. This approach does not involve defining new elements, unlike Option A, and does not involve significant modification of existing definitions of an asset and a liability, unlike Option C. The overarching term “other economic phenomena” been used in section 1 of this chapter to describe such items and the more detailed terms “other obligations” and “other resources” have been used in subsequent sections. The circumstances under which “other obligations and “other resources” will be recognized will be determined at standards level and explained in the Bases for Conclusions of specific standards.~~

~~Financial Statements~~

~~BC16. 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 to be recognised in them.~~

BC2. The IPSASB acknowledged a view that elements of cash inflows and cash outflows related to the cash flow statement should be developed. However, the IPSASB considered that further guidance on what constitutes a cash inflow or a cash outflow should be provided at standards-level.

Comment: Paragraphs BC3 and BC 4 have been deleted because they do not provide analysis of an issue or a conclusion for an IPSASB decision.

Section 2: Assets

A Resource

~~BC17. 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.~~

~~BC18. 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 and Executory Contracts

Staff Comment: Staff considers previous paragraph BC19 immediately below to be unnecessary and has deleted it.

There are a number of drafting changes.

Staff considers that material deleted from paragraph BC16 as a result of a direction at the June meeting contains some useful explanatory material and should be retained.

~~BC19. CF-ED2 discussed unconditional rights and executory contracts. The IPSASB considered whether the Framework should specifically address unconditional rights and executory contracts.~~

BC320. Unconditional rights to resources 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-acknowledged~~ 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~~are recognized will be ~~dependent~~depend on whether recognition criteria have been satisfied. ~~The IPSASB concluded that the Framework should not specifically address unconditional rights.~~The IPSASB concluded that the

consequences of application of the definition of an asset to unconditional rights should be addressed at standards level.

BC424. Executory contracts are binding arrangements, where there is an unconditional promise-right to receive resources and an equal promise-present obligation 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 there is a right to receive resources -and 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.

BC5. 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 of elements and recognition criteria identified in this Conceptual Framework. Such assessments and mechanisms for the approach to presentation in the financial statements of any elements arising from executory contracts that best satisfy the QCs will be considered at standards level. The IPSASB therefore decided not to address executory contracts specifically in the Framework.

Service Potential and Economic Benefits

BC622. 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. O- others argue that service potential includes economic benefits, and still others while a further view is -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.

BC723. The IPSASB noted that many respondents to the Consultation Paper and Exposure Draft and had supported inclusion of a specific reference to service potential as a characteristic of an asset, because of the service delivery objectives of most public sector entities. The IPSASB therefore concluded that the explanation of a resource should include both the terms service potential and economic benefits. This approach acknowledges 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 Control

BC~~8~~24. 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.

BC~~9~~25. Legal ownership of the underlying resource, such as a property or item of equipment, is one method of accessing the service potential or economic benefits provided by an asset. However, rights to ~~benefits~~service potential or economic benefits may exist without legal ownership of the underlying resource. For example, the rights to ~~the service potential or benefit~~economic 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.

BC~~10~~26. 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~~resource for another asset, such as cash, or (c) use the asset in any of the other ways that may provide services or economic 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.~~

BC~~11~~27. 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 restrict access to those who do not pay the fee, 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 ~~resources~~benefits such as a right of access to a road~~road access~~ or a right 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 that do not require~~ 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.~~

~~BC28.~~ The IPSASB took the view that the factors identified in paragraph BC~~8~~ 24 are likely to be persuasive indicators of the existence of control rather than essential characteristics of the definition of an asset. ~~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.~~

BC~~12~~29. 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-CP2the Exposure Draft](#), 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.

BC1330. 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 in order~~ 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 the party that controls an asset. The IPSASB therefore decided not to include the risks and rewards of ownership as an indicator of control.. 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

BC1431. Some [respondents to the Consultation Paper and Exposure Draft](#) argued that identification of a past transaction or other event which gives rise to the asset ~~is~~ should be an essential characteristic of ~~an asset~~ the definition 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~~ 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 the more important issue of whether ~~the~~ rights to resources 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~~ provides useful supporting evidence of the existence of an asset, but not that it should be an essential characteristic.

BC1532. 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 control of a~~ resource might arise. ~~Therefore the IPSASB concluded that and therefore~~ identification of the appropriate past event is crucial in identifying whether an asset exists.

BC1633. ~~As highlighted in the Preface to the Conceptual Framework, t~~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 ~~public-sector specificsovereign~~ powers. ~~Given the significant powers that accrue to sovereign governments and, in certain circumstances, other public sector entities, i~~It is often difficult to determine when such powers give rise to a right that is a resource and asset of the entity.

BC1734. 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 an acknowledgement 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~~[the Consultation Paper and Exposure Draft](#) supported this latter view. The IPSASB agreed with these respondents. In particular, the IPSASB ~~considered-concluded~~ 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

Staff comment: Minor editorial changes have been made to this section.

BC1835. In considering when obligations are present obligations, the IPSASB accepted that a legal obligation gives 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 "non-legally binding obligations" was the most straightforward and understandable approach. The IPSASB considered and rejected the view that the term "non-legally binding obligations" [might be interpreted as referreferrings](#) to obligations, the legality of which is questionable. Paragraphs [BC33-35](#) discuss ~~es~~ non legally-binding obligations [and explain their meaning for the purposes of this Framework](#).

BC1936. In the context of a present obligation the IPSASB considered conditional and unconditional obligations, stand-ready obligations and performance obligations [might qualify as present obligations and therefore as liabilities](#).

Conditional and Unconditional Obligations

BC2037. 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 little or 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. BC38.

BC2138. 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 and the conclusions reached by the IPSASB in the context of the Conceptual Framework are outlined below.

Stand-Ready Obligations

BC2239. Stand-ready obligations are a type of conditional obligation. Stand-ready obligations 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 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 obligation to transfer resources if a 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.~~

BC2340. CF-ED2 The Consultation Paper included a discussion of stand-ready obligations. Many respondents found the distinction between a stand-ready obligation and other conditional obligations ambiguous. The Exposure Draft explained that the term stand-ready obligation is not widely used in the public sector, and does not work well in certain public sector circumstances, in the public sector and suggested that 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 the Exposure Draft, and expressed a view 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.

BC2444. 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. The IPSASB decided that the Framework should not resolve whether all obligations that might be classified as stand-ready meet the definition of a liability and decided not to use the term stand-ready obligation in the Framework.

Performance Obligations

BC2542. A performance obligation is an obligation in a contract or other binding arrangement between an ~~in 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.

BC2643. 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~~ provide 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. The IPSASB concluded that the circumstances under which performance obligations give rise to liabilities should be considered at standards-~~level~~.

Past Event

BC2744. The IPSASB considered whether the definition of a liability should require the existence of a past transaction or other event. Some ~~commentators contend~~ take the view 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-identification of a past event is ~~irrelevant not a primary factor~~ in determining whether a liability exists at the reporting date. This view mirrors the opposition to the inclusion of a past event in the definition of an asset, which is discussed in paragraphs ~~B-BC14-17C34~~.

BC2845. The IPSASB acknowledged this view, but also noted that many respondents to ~~CF-CP2~~ the Consultation Paper and ~~CF-ED2~~ Exposure Draft 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: Staff has made some drafting changes to this sub-section.

BC2946. Some respondents to ~~CF-ED2~~the Exposure ~~were~~Draft 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 in order to reduce the potential for misinterpretation. The IPSASB considered this proposal~~al~~ but was concerned that ~~the removal of these words may~~such a change might 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 binding or non-legally binding requirement that an entity has little or no realistic alternative to avoid.

BC3047. 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, might~~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 also over time within the same jurisdiction. For example, different age cohorts are likely to~~may~~ have different expectations about the likelihood of receiving benefits under a social assistance program. Assessing whether a government cannot ignore such expectations and therefore has little or no realistic alternative to transfer resources may be subjective. Some may be concerned~~This gives rise to concerns~~ that such ~~variation subjectivity does not promote~~undermines consistency ~~in in the reporting of of these obligations as~~ liabilities, and can ~~mean that information reported on liabilities does not meet the QC of~~also impact adversely on understandability. ~~This may lead to a view~~Some therefore take the view that an essential characteristic of a liability should be that it is enforceable at the reporting date by legal or equivalent means.

BC3148. A converse view is that where a government has a record of honoring obligations, failing to recognize them as liabilities leads to an understatement-overstatement of that government’s liabilities~~net financial position~~. For example, if a government has a consistent record ~~of of raising citizen expectations through meeting~~ publicly-announced obligations to provide financial support to the victims of natural disasters and has met such obligations in the past, a failure to treat such obligations as liabilities is not in accordance with the objectives of financial reporting and, in particular, does not meet the QCs of faithful representation and relevance.

BC32.49. 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 “non-legally 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 obligations that are not legally enforceable. Consequently, paragraph 3.104 of this Chapter identifies the attributes that a non-legally binding obligation is to possess for it to give rise to a liability.

BC3350. 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 ~~pledges-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 such circumstances might give rise to a liability. In assessing whether, in these circumstances, a non-legally binding obligation gives rise to a liability the availability of funding to settle the obligation may be an ~~un-persuasive~~ indicator. [This is discussed in paragraph 3.12\(c\).](#)

Sovereign Power to Avoid Obligations

BC3451. 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-CP2the Consultation Paper](#) and [CF-ED2the Exposure Draft](#) 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

BC3552. 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. [The IPSASB concluded that commitment accounting should be addressed in the future when dealing with elements for the more comprehensive areas of general purpose financial reporting outside the financial statements.](#)

Section 4: Other Resources and Other Obligations and Net Financial Position

Staff comment: Material on the development of the IPSASB's approach to deferred flows and the reason for deciding to acknowledge that other economic phenomena (other resources and other obligations) may be recognized to meet the objectives of financial reporting has been relocated from paragraphs BC2-BC15 in the June version. More detail on the reasons for rejecting four of the five options discussed at the December 2013 meeting have been included in paragraphs BC53-BC58. In paragraph BC47 a small amount of material has been added on the two Alternative Views in the Exposure Draft.

BC3653. This section of the Basis for Conclusions considers the IPSASB's approach to models of financial performance and specifically the treatment of deferred inflows and outflows from the approaches discussed in the Consultation Paper and Exposure Draft.

Conceptual Framework Consultation Paper, Elements and Recognition in Financial Statements

BC37. The Consultation Paper 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)); 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. This was described as the revenue and expense-led approach (R & E-led approach).

BC38. The Consultation Paper 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 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.

BC39. A further section of the Consultation Paper discussed "Other Potential Elements" and pointed out that, if IPSASB adopted the R & E-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. The Consultation Paper identified three options for dealing with deferred flows:

- Defining deferred inflows (DIs) and deferred outflows (DOs) as elements on the statement of financial position;
- Broadening the asset and liability definitions to include items that are deferrals; or
- Describing deferred flows as sub-classifications of net assets/net liabilities (subsequently referred to as the residual amount).

BC40. The Consultation Paper 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 their reasons. The second asked whether deferrals need to be identified on the statement

of financial position. If respondents supported identification on the statement of financial position they were asked to indicate which of the three approaches in paragraph BC42 they supported.

BC41. The responses to these SMCs were inconclusive. 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. The IPSASB took these views into account at Exposure Draft stage.

Conceptual Framework Exposure Draft, Elements and Recognition in Financial Statements

BC42. Following extensive discussions in the second half of 2011 and the first half of 2012 the IPSASB issued the *Exposure Draft, Elements and Recognition in Financial Statements* in November 2012. The Exposure Draft 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. The Exposure Draft therefore proposed definitions of a DI and 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.

BC43. 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.

BC44. 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. The Exposure Draft included two Alternative Views (AVs). The first AV considered the sense of net financial position as an indicator to be unclear in light of the combined impact of deferred inflows and deferred outflows. The second AV disagreed with the view that deferred inflows and deferred outflows should be identified and recognized as separate elements and expressed a view that these flows should be included in the definitions of revenues and expense.

BC45. A SMC in the Exposure Draft 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.

BC46. Most respondents disagreed with defining DIs and DOs as elements. Many 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 expense under the R&E-led model. Nevertheless, a number of respondents also expressed the view that information on flows relating to particular reporting periods has information value.

BC47. The rationale for restricting the definitions to non-exchange transactions was challenged as conceptually weak both by respondents who favored defining DIs and DOs as elements and those opposed to these proposed elements. 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.

Finalizing the Elements Chapter

BC48. The IPSASB considered that it needed to balance the limited support for the proposals on deferred flows in the Exposure Draft, with a view that it needed to respond to the perceived needs of users for information about flows relating to particular reporting periods.

BC49. The IPSASB therefore considered five approaches in responding to input from the due process and its perception of user information needs:

- 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 revenue and expense 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 expense.

BC50. The IPSASB did not consider that defining DIs and DOs as elements in Option A was justified in light of the objections that respondents had made to the proposals in the Exposure Draft. The IPSASB therefore rejected Option A.

BC51. The IPSASB considered two variants of Option B. 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.

BC52. The IPSASB considered that taking deferred flows directly to surplus/deficit under the first variant of Option B may not produce information that is representationally faithful of an entity's sustainable performance and therefore does not meet the objectives of financial reporting. The second variant of Option B relies on recycling and, in the view of some IPSASB members would have implicitly introduced notion of "other comprehensive income" into the Framework. The IPSASB had strong reservations about such a development. For these reasons the IPSASB rejected Option B.

BC53. The IPSASB noted that Option C would require changes to the definitions of an asset and a liability so that:

- The definition of an asset would include resources that an entity does not control; and

- The definition of a liability would include obligations that are not present obligations.

The IPSASB considered that such changes would distort the essential characteristic of an asset (that an entity controls resources) and the essential characteristic of a liability (that an entity has a present obligation for an outflow of resources). In the view of the IPSASB this would make assets and liabilities less easily understandable. Adoption of such an option would also be a departure from globally understood definitions of an asset and a liability. For these reasons the IPSASB rejected Option C.

BC54. Option E was a hybrid approach that involved components of the other four options. It would allow reporting of inflows and outflows that provide service potential or economic benefits, but would not affect the definitions of an asset and liability and the reporting of inflows and outflows that do not affect revenue and expense as defined in the Framework. The idea of this approach was to acknowledge that further conceptual thinking.

BC55. Option D is broader than Option E because it is not necessarily restricted to deferred flows, but could encompass broader economic phenomena; for example obligations that are not present obligations, because, although they contain performance obligations it is not clear that they require an outflow of resources. Option D therefore acknowledges that there may be circumstances under which the six defined elements may not provide all the information in the financial statements that is necessary in order to meet user needs. In the view of the IPSASB it is transparent to acknowledge that other items may be recognized. Unlike Option A, Option D does not involve defining additional elements, and, unlike Option C, Option D does not involve modification of existing definitions of an asset and a liability.

BC56. The IPSASB concluded that Option D provides the most transparent approach. The overarching term “other economic phenomena” is used in section 1 of this chapter to describe such items and the more detailed terms “other obligations” and “other resources” have been used in subsequent sections. Option D also enhances the accountability of the IPSASB because the circumstances under which “other obligations and “other resources” will be recognized will be determined at standards level and explained in the Bases for Conclusions of specific standards.

Financial Statements

~~BC53The reason for acknowledging that other resources and other obligations might be recognized in the financial statements and the IPSASB reason for this conclusion is given in paragraphs BC14.~~

BC5754. Net financial position is the aggregate of an entity's net assets (assets minus liabilities) and other resources and other obligations recognized in the statement of financial position at the reporting date. Where resources and obligations other than those ~~encompassed by that meet the definition of~~ the elements are recognized in the financial statements, the amounts reported as net assets and net financial position will differ. In these circumstances, the interpretation of net financial position will be determined by reference to the nature of the ~~additional other~~ resources and ~~other~~ obligations recognized in the financial statements under the relevant IPSAS.

BC5855. The IPSASB considered whether it should use both the terms ‘net assets’ and ‘net financial position’ in the Framework. The IPSASB acknowledged a view that net assets is a generally understood term. However, the IPSASB decided that using both terms could be confusing and therefore decided to use the term net financial position to indicate the residual amount of an entity.

Section 5: Revenue and Expense

Nature of Revenue and Expense

Staff comment: The issue of whether the definition of revenue should reflect a gross or net increase in net financial position is considered in the Issues Paper.

Much of this section has been deleted because it duplicates [Section 4](#).

~~BC56. 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.~~

~~BC57. Consistent with the proposal to define Dis and Dos discussed in paragraphs 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 DIs and DOs 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 increase or decrease net assets other than DIs, DOs, ownership contributions and ownership distributions.~~

~~BC58. As noted in paragraph BC11, a majority of respondents to CF-ED2 did not support the identification of DIs and DOs 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-ED2 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.~~

BC59. The IPSASB's decision to acknowledge that other resources and other obligations might be recognized in the financial statements required a modification of the definitions of revenue and expense. The definitions of revenue and expense in section 5 of this [Chapter](#) reflect this approach.

Gross or Net Increase in "Net Financial Position" [in Definition of Revenue](#)

BC60. The IPSASB considered whether the definition of revenue should [specify that the be the "net" or "gross" increase in net financial position is "gross" or "net"](#). The IPSASB recognized that a "gross" approach [would create problems might not be appropriate](#) 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](#) Conversely presentation of [the relevant flows](#) the "net" position on the face of the financial statements in certain circumstances, for example, the sale of inventory, [might be similarly inappropriate. The IPSASB concluded that whether the increase in net financial position represented by revenue should be presented gross or net should](#)

be determined at standards level, dependent on which treatment better meets the objectives of financial reporting.

Distinguishing Ordinary Activities from Activities outside the Ordinary Course of Operations

BC614. 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, expense, gains and losses as separate elements, where revenue and expense 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.⁵

BC622. 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 expense, because they both involve net increases or decreases of assets and/or liabilities. The IPSASB also noted that many respondents to [CF-CP2the Consultation Paper](#) and [CF-ED2Exposure Draft](#) shared this view. Therefore the IPSASB decided not to define gains and losses as separate elements.

BC3653. As discussed in more detail in BC68-7066-68, the IPSASB considered whether, and, if so, under what circumstances, ownership interests exist in the public sector. ~~In the context of revenue and expense the IPSASB considers~~ sector and whether transactions related to ownership interests should be excluded from the definitions of revenue and expense. 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 in section 6 of this chapter and excluded from the definitions of revenue and expense.

Surplus or deficit in the reporting period

BC644. Section 5 of this chapter states that the difference between revenue and expenses is the entity's surplus or deficit for the period. The IPSASB considered whether it should provide explanatory guidance on the interpretation of surplus or deficit. The IPSASB discussed ~~the a~~ view that public sector entities have an operating and funding model, ~~which is the equivalent of the business model in the profit-oriented sector. Relating this model~~ According to this view ~~to~~ the surplus or deficit of a period, a surplus ~~would provide~~ provides an indicator of the ability of the entity to (i) reduce demands for resources from resource providers; (ii) increase either the volume and/or quality of services to recipients; (iii) ~~increase the financial resilience of an entity by reducing~~ reducing debt (where an entity has debt-raising powers); or (iv) a combination of these factors. Conversely a deficit provides an indicator of (i) the need to increase demands on resources from resource providers; (ii) reduce either the volume and/or quality of services to recipients; (iii) ~~reduce the financial resilience of the~~

⁵ See for example Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 6: Elements of Financial Statements.

entity by increasing debt (where an entity has debt-raising powers), or (iv) a combination of these factors.

BC655. The IPSASB acknowledged that there is a need for greater clarity on the meaning of surplus or deficit in the public sector and therefore that these insights aspects of the above approach should be refined might be developed further in the future. However, the IPSASB considered the concept of an operating and funding model or business model is not well developed in the public sector and, further, that developing an operating and funding models may vary globally appropriate for all public sector entities is problematic. The IPSASB therefore decided not to include guidance on the interpretation of surplus or deficit.

Section 6: Ownership Contributions, and Ownership Distributions

Staff comment: Staff has made minor editorial changes.

BC666. The IPSASB considered whether net financial position is a residual amount, a residual interest or an ownership interest. The IPSASB acknowledged the view that the interest of resource providers and service recipients in the long-term efficiency of the entity, its capacity to deliver 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 supporters of this approach argue that this emphasizes the democratic accountability of governments.

BC677. 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 resources in the event of the entity being wound up. The IPSASB therefore concluded that the terms residual interest and ownership interest can be misunderstood or misinterpreted, and that net financial position is a residual amount that should not be defined.

~~BC688~~BC68. However, the IPSASB acknowledged that part of net financial position can in certain circumstances be an ownership interest. Such instances may be evidenced by the entity having a formal equity structure, but there may be instances where an entity is established without a formal equity structure, with a view to sale for operation as a commercial enterprise or by a private sector not-for-profit entity. An ownership interest can also arise from the restructuring of government or public sector entities, such as when a new government department is created. The IPSASB therefore considered whether "ownership interests" should be defined as an element. The IPSASB acknowledged the view that identifying the resources (or claims on future resources) attributable to owners provides information useful for accountability and decision-making purposes. The IPSASB concluded that such interests can be identified through the sub-classification of net financial position. However, the IPSASB also concluded that it is important to distinguish inflows of resources from owners and outflows of resources to owners, in their role as owners, from revenue, expenses, other resources and other obligations. 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~~will be developed at standards level as appropriate.

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

TABLE OF CONTENTS TO BE UPDATED IN INTEGRATED FRAMEWORK.

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1. Introduction

Staff Comment: The direction at the June meeting was that linkages between the elements and particular should be “softened”, TBG was not supportive of Staff’s attempts to achieve this, which TBG found ambiguous. TBG’s view is that linkage with the financial statements is covered elsewhere in the chapter and that the references to particular statements in paragraph 1.2 are unnecessary. They have therefore been deleted.

Footnotes 1 and 2 have been deleted as it is unnecessary to include detail on material in Chapters 2 and 3 in the finalized version.

Both the narrative description and formula for net financial position have been deleted and a cross-reference to section 4 inserted in accordance with directions at the June meeting.

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.

Elements and their Importance

- 1.2 Financial statements portray the financial effects of transactions and other events by grouping them into broad classes which share common economic characteristics. These broad classes are termed the elements of financial statements. Elements are the building blocks from which financial statements are constructed. These building blocks provide an initial point for recording, classifying and aggregating economic data and activity in a way that provides users with information that meets the objectives of financial reporting and satisfies the qualitative characteristics (QCs) of financial reporting and the constraints on information included in GPFRs.
- 1.3 The elements defined in this Chapter do not refer to the individual items that are recognized as a result of transactions and events. Sub-classifications of individual items within an element and aggregations of items are used to enhance the understandability of the financial statements. Presentation is addressed in Chapter 8, *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.

Elements Defined and Approach to Recognition

1.5 The elements that are defined in this Chapter are:

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

1.6 Net financial position is determined by amounts of assets, liabilities, other resources and other obligations. Net financial position is discussed in section 4.

2. Assets

Staff Comment: The definition of an asset has been modified to better align with IASB definition in accordance with directions at the June meeting. However, at the June meeting the IPSASB decided not to replace “past event” with “past events”.

Definition

2.1 An asset is a resource presently controlled by the entity as a result of a past event.

A Resource

Staff Comment: The direction at the June meeting was to use the more concise phrase “capable of providing service potential” in the description of a resource. However, because the description of service potential includes “capacity to provide services” it is unnecessary to use the phrases “capable of” or “ability to” in the description of a resource in paragraph 2.2. This also applies to economic benefits.

“Necessarily” has been reinserted in paragraph 2.3 in accordance with direction at June meeting, as some assets primarily held for service delivery do generate cash flows.

A reference to cash has been reinserted in paragraph 2.5 and the explanation of economic benefits slightly modified.

2.2 A resource is an item with 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 item itself or from the rights to use 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 services¹;
- (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; or
- (e) Receive a stream of cash flows.

2.3 Service potential is the capacity 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 which are used to 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*) many assets that embody service potential are specialized in nature.

2.5 Economic benefits are the ability to provide cash inflows or a reduction in cash outflows. Cash inflows (or reduced cash outflows) may be derived from, for example:

¹ References to “services” in this Conceptual Framework encompass “goods and services”.

- (a) An asset's use in the production and sale of services; or
- (b) The direct exchange of an asset for cash or other resources;

In addition, a resource, such as cash, may be held to settle a liability or to make an ownership distribution.

Presently Controlled by the Entity

- 2.6 **Staff Comments:** The title has been changed as a consequential to changes in the definition. In paragraph 2.8 the assertion that identification of the past event is straightforward for exchange transactions has been deleted in accordance with the direction at the June meeting. The penultimate sentence has been amended to focus actively on past event giving rise to a resource, rather than the obligation of external party. There has been significant further redrafting of paragraph 2.8. 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 presently controls a resource, an entity assesses whether the following indicators of control exist:
- (a) Legal ownership;
 - (b) Access to, or, , 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.

Past Event

- 2.8 The definition of an asset requires that a resource that an entity presently controls must have arisen from a past transaction or other past event. The past transactions or other events that result in an entity gaining control of a resource and therefore an asset may differ. Entities can obtain assets by purchasing them in an exchange transaction or developing them. Assets may also arise through non-exchange transactions, including through the 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 public sector-specific powers and rights that may give rise to assets. For an entity to receive resources in the form of taxes, the following events 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 the right to receive resources from an external party. When the power is exercised and the rights exist to receive resources, an asset arises.

3. Liabilities

Staff comment: A very minor change has been made to the definition to align with the current draft IASB definition. However, the IPSASB decided not to adopt the IASB's term "transfer (an economic resource)" because of the connotations of "transfer" in the public sector in relations to transfers between different levels of government and social benefits.

The IPSASB directed that "binding" should be added as a suffix to "legal" in legal obligation. TBG proposes the term "legally binding obligation" is used on first reference on grounds that this is consistent with the term "non-legally binding". On subsequent usage the more readable term legal obligation is used.

In paragraph 3.2 staff has added text to distinguish present obligations and other obligations.

Paragraph 3.4 has been redrafted.

In paragraph 3.13 (c) the presumption that where both (i) a budget line item has been approved and (ii) linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, has been removed.

Paragraph 3.6 on economic coercion and political necessity has been relocated to paragraph 3.13, as it is more appropriate to include it in the section on non-legally binding obligations.

Definition

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

A Present Obligation

3.2 Obligations are acts or courses of action which an entity is bound take. A present obligation is a legally binding (legal obligation) or non-legally binding obligation which an entity has little or no realistic alternative to avoid. Public sector entities can have a number of obligations. However, these obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid the obligation.

An Outflow of Resources from the Entity

3.3 A liability must involve an outflow of resources from the entity for it to be settled. An obligation that can be settled without an outflow of resources from the entity is not a liability.

Past Event

3.4 The complexity of public sector programs and activities means that a number of commitments may be made and a number of obligations may arise in the development, implementation and operation of a particular program. For financial reporting purposes it is necessary to determine whether such commitments and obligations, including binding obligations that the entity has little or no realistic alternative to avoid but are not legally enforceable (referred to as "non-legally binding obligations" in this Conceptual Framework) are present obligations and satisfy the definition of a liability. To satisfy the definition of a liability, it is necessary that a present obligation arises as a result of a past transaction or other event and requires an outflow of resources from the entity. Where an arrangement has a legal form and is binding, such as a contract, the past event may be straightforward to identify. In other cases, it may be more difficult to identify the past event and

identification involves an assessment of when an entity has little or no realistic alternative to avoid an outflow of resources from the entity. In making such an assessment an entity takes jurisdictional factors into account.

Legal and Non-Legally Binding Obligations

- 3.5 Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations 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 an external party 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 a 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 obligation involves an outflow of resources and gives rise to a liability. 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 enter into 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 law². 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 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 are enforceable obligations in the context of the definition of a liability.
- 3.9 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 legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.

² References to obligations enforceable in law encompass legal obligations and binding obligations subject to alternative processes with equivalent effect.

Non-Legally Binding Obligations

- 3.10 Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give 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.
- 3.11 In the public sector, obligations may arise at a number of points. For example, in implementing a program or service :
- (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).
- 3.12 These early stages of implementation are unlikely to give rise to present 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. Factors 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 a non-legally 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 a non-legally 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, a non-legally binding obligation may exist. However the absence of a budgetary provision is not a reason for not recognizing an obligation that otherwise meets the definition of a liability and the recognition criteria.

- 3.13 “Economic coercion”, “political necessity” or other circumstances may give rise to situations, where, although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to incur an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.

4. Other Resources and Other Obligations and Net Financial Position

Staff comment: Issues Paper discusses the title of this section Paragraph 4.1 has been deleted in accordance with directions at the June meeting. Staff thinks that the second sentence deleted from paragraph 4.3 is useful and should be retained.

Other Resources and Other Obligations

- 4.1 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 defined in this Conceptual Framework should be recognized 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”, which are items additional to the six elements defined in this Framework.

Net Financial Position

- 4.2 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.
- 4.3 All items that meet the definition of assets and liabilities, and satisfy the recognition criteria set out in Chapter 6 are reported on the statement of financial position. Net financial position can be a positive or negative residual amount

5. Revenue and Expense

Staff comments:

The definitions of revenue and expense are those agreed at the June meeting with the exception that the phrase “those arising from” have been added because ownership contributions and ownership distributions are not included in the calculation of net financial position. Two sentences have been added to paragraph 5.3 indicating that revenue and expense can arise through changes in previously recognized other resources and other obligations.

The Issues Paper discusses whether definitions should specify whether increases and decreases in net financial position are gross or net and reflects the view of the TBG that the Framework should be neutral on this issue

Staff has reservations about the reference to price changes, in paragraph 5.3, because (i) the treatment of price changes, is linked to concepts of capital and capital maintenance where the IPSASB has acknowledged in the Measurement phase that work needs to be carried out in future and (ii) given the linkage of revenue and expense to the statement of financial performance.

Other changes are editorials.

Definitions

5.1 Revenue is:

Increases in the net financial position of the entity, other than increases arising from ownership contributions; and

5.2 Expense is:

Decreases in the net financial position of the entity, other than decreases arising from ownership distributions; and

5.3 Revenue and expense arise from exchange and non-exchange transactions, other events such as, 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. Revenue can also arise through reductions in amounts recognized as other obligations in previous reporting periods. Expense can also arise through reductions in amounts recognized as other resources in previous reporting periods. Revenue and expense may arise from individual transactions or groups of transactions.

Surplus or deficit for the Period

5.4 All items that meet the definition of revenues and expense and the recognition criteria set out in Chapter 6 are reported on the statement of financial performance. The entity's surplus or deficit for the period is the difference between revenue and expense reported on the statement of financial performance.

6. Ownership Contributions and Ownership Distributions

Staff Comment: Following considerable discussion at the June meeting the definitions of ownership contributions and ownership distributions were retained. Staff expressed reservations that the current definitions may be flawed, because they suggest that there can be ownership interests in resources that an entity does not presently control as a result of a past transaction or other event and that ownership interests may be depleted by obligations that are not present obligations. TBG does not support Staff reservations and is comfortable with current wording, so it has been retained.

Definitions

- 6.1 Ownership contributions are inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity.
- 6.2 Ownership distributions are outflows of resources from the entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the net financial position of the entity.
- 6.3 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 expense. In addition to the injections of resources and the payment of dividends 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.
- 6.4 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.
- 6.5 Ownership contributions may take the form of an initial injection of resources at the creation of an entity or a subsequent injection of resources, including those where an entity is restructured. Ownership distributions may be; a) a return on investment; b) a full or partial return of investment; or, c) in the event of the entity being wound up or restructured, a return of any residual resources.

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), which was issued in December 2010, 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 the need to develop such elements in the future. However, the IPSASB, 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.

Staff Comment: Material on the development of the IPSASB’s approach to “other economic phenomena” has been relocated to section 4: Net Financial Position. Paragraph BC3 has been inserted to acknowledge that there might be other elements of the financial statements.

- BC2. The IPSASB acknowledged a view that elements of cash inflows and cash outflows related to the cash flow statement should be developed. However, the IPSASB considered that further guidance on what constitutes a cash inflow or a cash outflow should be provided at standards-level.

Comment: Paragraphs BC3 and BC 4 have been deleted because they do not provide analysis of an issue or a conclusion for an IPSASB decision.

Section 2: Assets

A Resource

Unconditional Rights and Executory Contracts

Staff Comment: Staff considers previous paragraph BC19 immediately below to be unnecessary and has deleted it.

There are a number of drafting changes.

Staff considers that material deleted from paragraph BC16 as a result of a direction at the June meeting contains some useful explanatory material and should be retained.

- BC3. Unconditional rights to resources 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 acknowledged 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 are recognized will depend on whether recognition criteria have been satisfied. The IPSASB concluded that the consequences of application of the definition of an asset to unconditional rights should be addressed at standards level.
- BC4. Executory contracts are binding arrangements, where there is an unconditional right to receive resources and an equal present obligation 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 there is a right to receive resources and a present obligation to sacrifice resources, which the entity has no realistic alternative to avoid.

- BC5. The IPSASB also acknowledged the view that recognizing assets and liabilities from executory contracts would involve the inclusion of potentially very large 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 of elements and recognition criteria identified in this Conceptual Framework. Such assessments and the approach to presentation in the financial statements of any elements arising from executory contracts is considered at standards level.

Service Potential and Economic Benefits

- BC6. 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, while a further view is that the terms can be used interchangeably. The IPSASB considered whether the explanation of a resource should include a reference to both service potential and economic benefits.
- BC7. The IPSASB noted that many respondents to the Consultation Paper and Exposure Draft and had supported inclusion of a specific reference to service potential as a characteristic of an asset, because of the service delivery objectives of most public sector entities. The IPSASB therefore concluded that the explanation of a resource should include both the terms service potential and economic benefits. This approach acknowledges that the primary objective of most public sector entities is to deliver services, but also that public sector entities may carry out activities with the sole objective of generating net cash inflows.

Control

- BC8. 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.
- BC9. Legal ownership of the underlying resource, such as a property or item of equipment, is one method of accessing the service potential or economic benefits of an asset. However, rights to service potential or economic benefits may exist without legal ownership of the underlying resource. For

example, the rights to service potential or economic 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.

- BC10. 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 resource for another asset, such as cash, or (c) use the asset in any of the other ways that may provide services or economic benefits.
- BC11. 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 restrict access to those who do not pay the fee, 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 resources, such as a right of access to a road or a right 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 that do not require legal rights. The IPSASB took the view that the factors identified in paragraph BC8 are likely to be persuasive indicators of the existence of control rather than essential characteristics of the definition of an asset.
- BC12. 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 the Exposure Draft, 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.
- BC13. The IPSASB considered whether an analysis of exposure to the risks and rewards of ownership is a useful indicator of control. The control approach focuses on the power of the entity to direct how the resource is used in order 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 the party that controls an asset. The IPSASB therefore decided not to include the risks and rewards of ownership as an indicator of control.

Past Event

- BC14. Some respondents to the Consultation Paper and Exposure Draft argued that identification of a past transaction or other event which gives rise to the asset should be an essential characteristic of the definition 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. 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 the more important issue of whether rights to resources 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 accept that a past event provides useful supporting evidence of the existence of an asset, but not that it should be an essential characteristic.

- BC15. Many respondents 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 control of a resource might arise. Therefore the IPSASB concluded that identification of the appropriate past event is crucial in identifying whether an asset exists.
- BC16. The powers and rights of government are particularly significant for the identification of assets. 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 sovereign powers. It is often difficult to determine when such powers give rise to a right that is a resource and asset of the entity.
- BC17. 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 an acknowledgement 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 the Consultation Paper and Exposure Draft supported this latter view. The IPSASB agreed with these respondents. In particular, the IPSASB concluded 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

Staff comment: Minor editorial changes have been made to this section.

- BC18. In considering when obligations are present obligations, the IPSASB accepted that a legal obligation gives 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 obligation" 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-legally

binding obligations” was the most straightforward and understandable approach. The IPSASB considered and rejected the view that the term “non-legally binding obligations” might be interpreted as referring to obligations, the legality of which is questionable. Paragraphs BC33-35 discuss non legally-binding obligations and explain their meaning for the purposes of this Framework.

- BC19. In the context of a present obligation the IPSASB considered conditional and unconditional obligations, stand-ready obligations and performance obligations might qualify as present obligations and therefore as liabilities.

Conditional and Unconditional Obligations

- BC20. 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 little or 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.
- BC21. 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 and the conclusions reached by the IPSASB in the context of the Conceptual Framework are outlined below.

Stand-Ready Obligations

- BC22. Stand-ready obligations are a type of conditional obligation. Stand-ready obligations 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 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 obligation to transfer resources if a 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.
- BC23. The Consultation Paper included a discussion of stand-ready obligations. Many respondents found the distinction between a stand-ready obligation and other conditional obligations ambiguous. The Exposure Draft explained that the term stand-ready obligation is not widely used in the public sector, and does not work well in certain public sector circumstances, and suggested that whether a stand-ready obligation gave rise to a liability is a standards-level issue. Some respondents did not agree with the explanation in the Exposure Draft, and expressed a view 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.

BC24. 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. The IPSASB decided that the Framework should not resolve whether all obligations that might be classified as stand-ready meet the definition of a liability and decided not to use the term stand-ready obligation in the Framework.

Performance Obligations

BC25. A performance obligation is an obligation in a contract or other binding arrangement between an 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. 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.

BC26. 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 provide resources. Obligations that require an entity to provide access to a resource, but do not entail an outflow of resources 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. The IPSASB concluded that the circumstances under which performance obligations give rise to liabilities should be considered at standards level.

Past Event

BC27. The IPSASB considered whether the definition of a liability should require the existence of a past transaction or other event. Some take the view 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 identification of a past event is not a primary factor in determining whether a liability exists at the reporting date. This view mirrors the opposition to the inclusion of a past event in the definition of an asset, which is discussed in paragraphs BC14-17.

BC28. The IPSASB acknowledged this view, but also noted that many respondents to the Consultation Paper and Exposure Draft 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: Staff has made some drafting changes to this sub-section.

- BC29. Some respondents to the Exposure Draft 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 in order to reduce the potential for misinterpretation. The IPSASB considered this proposal but was concerned that such a change might 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 binding or non-legally binding requirement that an entity has little or no realistic alternative to avoid.
- BC30. 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, might 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 also over time within the same jurisdiction. For example, different age cohorts may have different expectations about the likelihood of receiving benefits under a social assistance program. Assessing whether a government cannot ignore such expectations and therefore has little or no realistic alternative to transfer resources may be subjective. This gives rise to concerns that such subjectivity undermines consistency in the reporting of liabilities, and can also impact adversely on understandability. Some therefore take the view that an essential characteristic of a liability should be that it is enforceable at the reporting date by legal or equivalent means.
- BC31. A converse view is that where a government has a record of honoring obligations, failing to recognize them as liabilities leads to an overstatement of that government’s net financial position. For example, if a government has a consistent record of raising citizen expectations through publicly-announced obligations to provide financial support to the victims of natural disasters and has met such obligations in the past, a failure to treat such obligations as liabilities is not in accordance with the objectives of financial reporting and, in particular, does not meet the QCs of faithful representation and relevance.
- BC32. 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 “non-legally 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 obligations that are not legally enforceable. Consequently, paragraph 3.10 of this Chapter identifies the attributes that a non-legally binding obligation is to possess for it to give rise to a liability.

BC33. 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 pledges. 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. 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 such circumstances might give rise to a liability. In assessing whether, in these circumstances, a non-legally binding obligation gives rise to a liability the availability of funding to settle the obligation may be an indicator. This is discussed in paragraph 3.12(c).

Sovereign Power to Avoid Obligations

BC34. 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 the Consultation Paper and the Exposure Draft 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

BC35. 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. The IPSASB concluded that commitment accounting should be addressed in the future when dealing with elements for the more comprehensive areas of general purpose financial reporting outside the financial statements.

Section 4: Other Resources and Other Obligations and Net Financial Position

Staff comment: Material on the development of the IPSASB's approach to deferred flows and the reason for deciding to acknowledge that other economic phenomena (other resources and other obligations) may be recognized to meet the objectives of financial reporting has been relocated from paragraphs BC2-BC15 in the June version. More detail on the reasons for rejecting four of the five options discussed at the December 2013 meeting have been included in paragraphs BC53-BC58. In paragraph BC47 a small amount of material has been added on the two Alternative Views in the Exposure Draft.

BC36. This section of the Basis for Conclusions considers the IPSASB's approach to models of financial performance and specifically the treatment of deferred inflows and outflows from the approaches discussed in the Consultation Paper and Exposure Draft.

Conceptual Framework Consultation Paper, Elements and Recognition in Financial Statements

BC37. The Consultation Paper 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)); 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. This was described as the revenue and expense-led approach (R & E-led approach).

BC38. The Consultation Paper 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 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.

BC39. A further section of the Consultation Paper discussed "Other Potential Elements" and pointed out that, if IPSASB adopted the R & E-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. The Consultation Paper identified three options for dealing with deferred flows:

- Defining deferred inflows (DIs) and deferred outflows (DOs) as elements on the statement of financial position;
- Broadening the asset and liability definitions to include items that are deferrals; or
- Describing deferred flows as sub-classifications of net assets/net liabilities (subsequently referred to as the residual amount).

BC40. The Consultation Paper 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 their reasons. The second asked whether deferrals need to be identified on the statement

of financial position. If respondents supported identification on the statement of financial position they were asked to indicate which of the three approaches in paragraph BC42 they supported.

BC41. The responses to these SMCs were inconclusive. 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. The IPSASB took these views into account at Exposure Draft stage.

Conceptual Framework Exposure Draft, Elements and Recognition in Financial Statements

BC42. Following extensive discussions in the second half of 2011 and the first half of 2012 the IPSASB issued the *Exposure Draft, Elements and Recognition in Financial Statements* in November 2012. The Exposure Draft 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. The Exposure Draft therefore proposed definitions of a DI and 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.*

BC43. 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.

BC44. 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. The Exposure Draft included two Alternative Views (AVs). The first AV considered the sense of net financial position as an indicator to be unclear in light of the combined impact of deferred inflows and deferred outflows, The second AV disagreed with the view that deferred inflows and deferred outflows should be identified and recognized as separate elements and expressed a view that these flows should be included in the definitions of revenues and expense.

BC45. A SMC in the Exposure Draft 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.

BC46. Most respondents disagreed with defining DIs and DOs as elements. Many 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 expense under the R&E-led model. Nevertheless, a number of respondents also expressed the view that information on flows relating to particular reporting periods has information value.

BC47. The rationale for restricting the definitions to non-exchange transactions was challenged as conceptually weak both by respondents who favored defining DIs and DOs as elements and those opposed to these proposed elements. 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.

Finalizing the Elements Chapter

BC48. The IPSASB considered that it needed to balance the limited support for the proposals on deferred flows in the Exposure Draft, with a view that it needed to respond to the perceived needs of users for information about flows relating to particular reporting periods.

BC49. The IPSASB therefore considered five approaches in responding to input from the due process and its perception of user information needs:

- 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 revenue and expense 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 expense.

BC50. The IPSASB did not consider that defining DIs and DOs as elements in Option A was justified in light of the objections that respondents had made to the proposals in the Exposure Draft. The IPSASB therefore rejected Option A.

BC51. The IPSASB considered two variants of Option B. 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.

BC52. The IPSASB considered that taking deferred flows directly to surplus/deficit under the first variant of Option B may not produce information that is representationally faithful of an entity's sustainable performance and therefore does not meet the objectives of financial reporting. The second variant of Option B relies on recycling and, in the view of some IPSASB members would have implicitly introduced notion of "other comprehensive income" into the Framework. The IPSASB had strong reservations about such a development. For these reasons the IPSASB rejected Option B.

BC53. The IPSASB noted that Option C would require changes to the definitions of an asset and a liability so that:

- The definition of an asset would include resources that an entity does not control; and

- The definition of a liability would include obligations that are not present obligations.

The IPSASB considered that such changes would distort the essential characteristic of an asset (that an entity controls resources) and the essential characteristic of a liability (that an entity has a present obligation for an outflow of resources). In the view of the IPSASB this would make assets and liabilities less easily understandable. Adoption of such an option would also be a departure from globally understood definitions of an asset and a liability. For these reasons the IPSASB rejected Option C.

- BC54. Option E was a hybrid approach that involved components of the other four options. It would allow reporting of inflows and outflows that provide service potential or economic benefits, but would not affect the definitions of an asset and liability and the reporting of inflows and outflows that do not affect revenue and expense as defined in the Framework. The idea of this approach was to acknowledge that further conceptual thinking.
- BC55. Option D is broader than Option E because it is not necessarily restricted to deferred flows, but could encompass broader economic phenomena; for example obligations that are not present obligations, because, although they contain performance obligations it is not clear that they require an outflow of resources. Option D therefore acknowledges that there may be circumstances under which the six defined elements may not provide all the information in the financial statements that is necessary in order to meet user needs. In the view of the IPSASB it is transparent to acknowledge that other items may be recognized. Unlike Option A, Option D does not involve defining additional elements, and, unlike Option C, Option D does not involve modification of existing definitions of an asset and a liability.
- BC56. The IPSASB concluded that Option D provides the most transparent approach. The overarching term “other economic phenomena” is used in section 1 of this chapter to describe such items and the more detailed terms “other obligations” and “other resources” have been used in subsequent sections. Option D also enhances the accountability of the IPSASB because the circumstances under which “other obligations and “other resources” will be recognized will be determined at standards level and explained in the Bases for Conclusions of specific standards.

Financial Statements

- BC57. Net financial position is the aggregate of an entity’s net assets (assets minus liabilities) and other resources and other obligations recognized in the statement of financial position at the reporting date. Where resources and obligations other than those that meet the definition of the elements are recognized in the financial statements, the amounts reported as net assets and net financial position will differ. In these circumstances, the interpretation of net financial position will be determined by reference to the nature of the other resources and other obligations recognized in the financial statements under the relevant IPSAS.
- BC58. The IPSASB considered whether it should use both the terms ‘net assets’ and ‘net financial position’ in the Framework. The IPSASB acknowledged a view that net assets is a generally understood term. However, the IPSASB decided that using both terms could be confusing and therefore decided to use the term net financial position to indicate the residual amount of an entity.

Section 5: Revenue and Expense

Nature of Revenue and Expense

Staff comment: The issue of whether the definition of revenue should reflect a gross or net increase in net financial position is considered in the Issues Paper.

Much of this section has been deleted because it duplicates Section 4.

BC59. The IPSASB's decision to acknowledge that other resources and other obligations might be recognized in the financial statements required a modification of the definitions of revenue and expense. The definitions of revenue and expense in section 5 of this Chapter reflect this approach.

Gross or Net Increase in "Net Financial Position" in Definition of Revenue

BC60. The IPSASB considered whether the definition of revenue should specify that the increase in net financial position is "gross" or "net". The IPSASB recognized that a "gross" approach might not be appropriate 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. Conversely presentation of the "net" position on the face of the financial statements in certain circumstances, for example, the sale of inventory, might be similarly inappropriate. The IPSASB concluded that whether the increase in net financial position represented by revenue should be presented gross or net should be determined at standards level, dependent on which treatment better meets the objectives of financial reporting.

Distinguishing Ordinary Activities from Activities outside the Ordinary Course of Operations

BC61. 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, expense, gains and losses as separate elements, where revenue and expense 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.³

BC62. 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 expense, because they both involve net increases or decreases of assets and/or liabilities. The IPSASB also noted that many respondents to the Consultation Paper and Exposure Draft shared this view. Therefore the IPSASB decided not to define gains and losses as separate elements

BC35. As discussed in more detail in BC68-70, the IPSASB considered whether, and, if so, under what circumstances, ownership interests exist in the public sector and whether transactions related to ownership interests should be excluded from the definitions of revenue and expense. Because

³ See for example Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 6: Elements of Financial Statements.

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 expense. Therefore ownership contributions and ownership distributions are defined as elements in section 6 of this chapter and excluded from the definitions of revenue and expense.

Surplus of deficit in the reporting period

- BC64. Section 5 of this chapter states that the difference between revenue and expense is the entity's surplus or deficit for the period. The IPSASB considered whether it should provide explanatory guidance on the interpretation of surplus or deficit. The IPSASB discussed a view that public sector entities have an operating and funding model. According to this view the surplus or deficit of a period, a surplus provides an indicator of the ability of the entity to (i) reduce demands for resources from resource providers; (ii) increase either the volume and/or quality of services to recipients; (iii) reduce debt (where an entity has debt-raising powers); or (iv) a combination of these factors. Conversely a deficit provides an indicator of (i) the need to increase demands on resources from resource providers; (ii) reduce either the volume and/or quality of services to recipients; (iii) increase debt (where an entity has debt-raising powers) , or (iv) a combination of these factors.
- BC65. The IPSASB acknowledged that there is a need for greater clarity on the meaning of surplus or deficit in the public sector and therefore that aspects of the above approach might be developed further in the future. However, the IPSASB considered the concept of an operating and funding model or business model is not well developed in the public sector and, , that developing an operating and funding model appropriate for all public sector entities is problematic. The IPSASB therefore decided not to include guidance on the interpretation of surplus or deficit.

Section 6: Ownership Contributions, and Ownership Distributions

Staff comment: Staff has made minor editorial changes.

- BC66. The IPSASB considered whether net financial position is a residual amount, a residual interest or an ownership interest. The IPSASB acknowledged the view that the interest of resource providers and service recipients in the long-term efficiency of the entity, its capacity to deliver 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 supporters of this approach argue that this emphasizes the democratic accountability of governments.
- BC67. 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 resources in the event of the entity being wound up. The IPSASB therefore concluded that the terms residual interest and ownership interest can be misunderstood or misinterpreted, and that net financial position is a residual amount that should not be defined.

BC68. However, the IPSASB acknowledged that part of net financial position can in certain circumstances be an ownership interest. Such instances may be evidenced by the entity having a formal equity structure, but there may be instances where an entity is established without a formal equity structure, with a view to sale for operation as a commercial enterprise or by a private sector not-for-profit entity. An ownership interest can also arise from the restructuring of government or public sector entities, such as when a new government department is created. The IPSASB therefore considered whether “ownership interests” should be defined as an element. The IPSASB acknowledged the view that identifying the resources (or claims on future resources) attributable to owners provides information useful for accountability and decision-making purposes. The IPSASB concluded that such interests can be identified through the sub-classification of net financial position. However, the IPSASB also concluded that it is important to distinguish inflows of resources from owners and outflows of resources to owners, in their role as owners, from revenue, expense, other resources and other obligations. 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 will be developed at standards level as appropriate.

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

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1. Recognition

Staff comment: Specific recognition criteria have been inserted in paragraph 1.1. In accordance with directions at the June meeting references to other resources and other obligations in paragraphs 1.3 and 1.4 have been deleted. The last sentence of paragraph 1.3 has been relocated to [paragraph BC2 of the Basis for Conclusions](#). Other changes are editorials identified at the June meeting.

Recognition Criteria and their Relationship to Disclosure

1.1 [The recognition criteria are that:](#)

- [The definition of an element has been satisfied and the element exists; and](#)
- [The element can be measured in a way that satisfies the Qualitative Characteristics \(QCs\).](#)

~~1.1~~ [1.2](#) 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 and constraints on information included in the [QCs financial statements](#). ~~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. Other resources and other obligations are discussed in Chapter 5.

~~1.3~~ [1.2](#) 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, [if any](#), 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, matters relevant to an assessment of uncertainty over the existence of an element will have been considered in determining whether the item satisfies the definition of an element.~~

Uncertainty: Existence of an Element

~~1.43~~ [In order to recognize an element the element must meet the definition of one of the elements in Chapter 5.](#) Uncertainty about the existence of an element is addressed by [assessing considering](#) 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 Chapter 5, Elements in Financial Statements, consistent with the requirements or guidance in an IPSAS, the item may be recognized as an "other economic phenomenon" (other resource or other obligation).~~

~~1.54~~ If it is determined that an element exists, uncertainty about the [flows amount](#) of service potential or economic benefits ~~related represented by~~ that element [is are](#) taken into account in the measurement of that element [\(see paragraphs 1.6 and 1.7.](#) ~~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 [exists and](#) should be recognized initially, whether that element continues to qualify for recognition (see paragraph 1.89), or whether there has been a change to an existing element.

Measurement Uncertainty

1.65 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 7, *Measurement of Assets and Liabilities in Financial Statements*.

1.7 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. Disclosures can provide useful information on estimation techniques. There may be rare instances in which the level of uncertainty in a single point estimate is so large that the relevance and faithful representativeness of the estimated information measure is questionable even if disclosures are provided to explain estimation techniques. Under these circumstances the element is not recognized.

Disclosure and Recognition

1.87 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 about 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-achieves the QCs 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.

Derecognition

1.98 Derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrant removing an element-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.

Recognition

Staff Comment. Paragraph BC8 has been deleted as it is unclear what issue it is addressing. Paragraph BC9 has been deleted, because it largely repeats paragraph 1.7.

Staff have made further drafting and editorial changes.

Recognition and its Relationship to the Definition of the Elements

- BC1. 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 criterion 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~~ is 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~~ the Consultation Paper and ~~CF-ED2~~ Exposure Draft supported the integration of recognition criteria in element definitions. After considering ~~this feedback~~ the input from the due process, the IPSASB concluded that ~~the definitions of element definitions should~~ elements should not include recognition criteria.
- BC2. In determining whether an element should be recognized there are two types of uncertainty that need to be considered. The first is uncertainty over the existence of an element—matters that will have been considered in determining whether an item meets the definition of an element.² The second is to consider measurement uncertainty—whether the element can be measured in ~~a representationally faithful~~ manner ~~that achieves the QCS~~.² The second aspect is ~~only~~ considered if it is determined that the definition of an element has been met. While recognition is viewed as a distinct stage in the accounting process, matters relevant to an assessment of uncertainty over the existence of an element will have been considered in determining whether the item satisfies the definition of an element.

Uncertainty: Existence of an Element

- BC3. The IPSASB considered whether, in dealing with ~~e~~ uncertainty over the existence of an element, (a) ~~standardized~~ standardized probability threshold criteria should be adopted, or (b) whether all available evidence should be used to make neutral judgements about an element's existence.
- BC4. Standardized evidence thresholds filter out 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.

- BC5. 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 whether it would satisfy the criteria for recognition.
- BC6. The IPSASB explored whether ~~uncertainty about the existence of an element is specific to certain components-characteristics~~ 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~~ such a view is that these are the essential characteristics of an asset and a liability where uncertainty is likely to arise.
- BC7. The IPSASB took the view that ~~in the context of assets and liabilities~~, uncertainty relates to more than just these characteristics. There might also be uncertainty about 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 BC2 these matters will also have been considered in determining whether an item satisfies the definition of an element.

~~BC8. The IPSASB also took the view that 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 e about existence is restricted to assets and liabilities.~~

Measurement Uncertainty

~~BC9. 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

~~BC10-BC8.~~ The IPSASB considered ~~the view that whether different the same~~ criteria should be used for initial recognition and derecognition. Many of the respondents the Consultation Paper and the

Exposure Draft 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.

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

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1. Recognition

Staff comment: Specific recognition criteria have been inserted in paragraph 1.1. In accordance with directions at the June meeting references to other resources and other obligations in paragraphs 1.3 and 1.4 have been deleted. The last sentence of paragraph 1.3 has been relocated to paragraph BC2 of the Basis for Conclusions. Other changes are editorials identified at the June meeting.

Recognition Criteria and their Relationship to Disclosure

1.1 The recognition criteria are that:

- The definition of an element has been satisfied and the element exists; and
- The element can be measured in a way that satisfies the Qualitative Characteristics (QCs).

1.2 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 and constraints on information included in the financial statements. 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. Other resources and other obligations are discussed in Chapter 5.

1.3 Recognition involves an assessment of uncertainty related to the existence and measurement of the element. The conditions that give rise to uncertainty, if any, can change. Therefore it is important that uncertainty is assessed at each reporting date.

Uncertainty: Existence of an Element

1.4 In order to recognize an element the element must meet the definition of one of the elements in Chapter 5. Uncertainty about the existence of an element is addressed by considering 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.

1.5 If it is determined that an element exists, uncertainty about the amount of service potential or economic benefits represented by that element is taken into account in the measurement of that element (see paragraphs 1.6 and 1.7. Preparers should review and assess all available evidence in determining whether an element exists and should be recognized initially, whether that element continues to qualify for recognition (see paragraph 1.9, or whether there has been a change to an existing element.

Measurement Uncertainty

1.6 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 7, *Measurement of Assets and Liabilities in Financial Statements*.

- 1.7 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. Disclosures can provide useful information on estimation techniques. There may be rare instances in which the level of uncertainty in a single point estimate is so large that the relevance and faithful representativeness of the measure is questionable even if disclosures are provided to explain estimation techniques. Under these circumstances the element is not recognized.

Disclosure and Recognition

- 1.8 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 about 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 achieves the QCs sufficiently 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.

Derecognition

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

Recognition

Staff Comment. Paragraph BC8 has been deleted as it is unclear what issue it is addressing. Paragraph BC9 has been deleted, because it largely repeats paragraph 1.7.

Staff have made further drafting and editorial changes.

Recognition and its Relationship to the Definition of the Elements

- BC1. The IPSASB considered whether 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 criterion of existence uncertainty is met, recognition should be considered as a distinct stage in the financial reporting process. This is because recognition is broader than whether the definition of an element is satisfied.. The IPSASB also noted that few respondents to the Consultation Paper and Exposure Draft supported the integration of recognition criteria in element definitions. After considering the input from the due process, the IPSASB concluded that the definitions of elements should not include recognition criteria.
- BC2. In determining whether an element should be recognized there are two types of uncertainty that need to be considered. The first is uncertainty over the existence of an element—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 manner that achieves the QCS. The second aspect is considered if it is determined that the definition of an element has been met. While recognition is viewed as a distinct stage in the accounting process, matters relevant to an assessment of uncertainty over the existence of an element will have been considered in determining whether the item satisfies the definition of an element.

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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 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 whether it would satisfy the criteria for recognition.

- BC6. The IPSASB explored whether uncertainty about the existence of an element is specific to certain characteristics 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 such a view is that these are the essential characteristics of an asset and a liability where uncertainty is likely to arise.
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Derecognition

- BC8. The IPSASB considered whether the same criteria should be used for initial recognition and derecognition. Many of the respondents to the Consultation Paper and the Exposure Draft 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.

Conceptual Framework: Elements and Recognition

The IPSASB considered the following issues:

- Relocation of material on recognition into new Chapter 6 and restructuring of Chapter 5;
- Definitions of revenue and expenses;
- Discussion of approach to deferred flows and other economic phenomena in Basis for Conclusions; and
- Discussion of financial performance in Basis for Conclusions.

Relocation of material on recognition into new Chapter 6 and restructuring of Chapter 5

The IPSASB confirmed the relocation of the section on Recognition to a separate chapter and agreed with the revised structure of the Elements chapter actioned by Staff in accordance with directions at the March 2014 meeting, apart from directing that the title of the section on “Other Resources and Other Obligations and Net Financial Position” should be shortened to “Net Financial Position.” The revised structure is:

- Introduction
- Assets
- Liabilities
- Net Financial Position
- Revenue and Expenses
- Ownership Contributions and Ownership Distributions

Definitions of Revenue and Expenses (STAFF NOTE: SEE ISSUES PAPER AT AGENDA ITEM 2B.1 FOR DISCUSSION OF WHETHER USAGE SHOULD BE “EXPENSE” OR “EXPENSES”)

The IPSASB decided to retain the word “expenses”, which had been used in both the 2010 Consultation Paper and the 2012 Exposure Draft, rather than adopt the singular “expense”, which is used by the IASB. The IPSASB rejected the revised definitions of revenue and expenses proposed by Staff in the Issues Paper and tentatively adopted more concise definitions:

- *Revenue is increases in the net financial position of an entity other than ownership contributions; and*
- *Expenses are decreases in the net financial position of an entity other than ownership distributions.*

Supporting narrative will outline the transactions, events and conditions that give rise to increases and decreases in net financial position and meet the definitions of revenue and expenses.

Discussion of approach to deferred flows and other economic phenomena in Basis for Conclusions

In general, the IPSASB supported the revised text on the development of the IPSASB’s thinking on deferred flows and the reasons why the IPSASB had concluded that certain economic phenomena that do not meet the definition of any element may need to be recognized in order to meet the objectives of financial reporting. The IPSASB directed that the Basis for Conclusions should provide greater detail on the other options identified for addressing the deferred flows issue at the December 2013 meeting and the reason

why these options had been rejected. The IPSASB also directed that the discussion should be relocated from the Introduction section of the Basis for Conclusions to the section on Net Financial Position.

Discussion of financial performance in Basis for Conclusions

Subject to minor drafting and editorial changes the IPSASB indicated that it was satisfied with the material on public sector financial performance (interpretation of surplus and deficit) that had been relocated from the core text to the Basis for Conclusions. The material discusses financial performance in the context of operating and funding model(s) in the public sector. It explained that, although the IPSASB acknowledged that there is a need for greater clarity on the meaning of surplus and deficit in the public sector, approaches to operating and funding models and the business model in the public sector are not well developed and, further, operating and funding models may vary globally. For this reason the IPSASB had decided not to include explanatory material on the interpretation of surplus or deficit in the core Framework.

Page-by-page review

The IPSASB carried out a page-by-page review of the two chapters and identified a number of drafting and editorial changes. During this page-by-page review the IPSASB considered whether there was scope for reducing unnecessary differences between the asset and liability definitions in the IPSASB's Conceptual Framework and the draft definitions in the IASB's Conceptual Framework project. The IPSASB noted that the definitions are similar; in particular both sets of definitions contain references to a "past event" (IPSASB) or "past events" (IASB). The IPSASB agreed to slight modifications, which reduced, but did not eliminate the differences in wording. The revised definitions are:

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

The IPSASB noted that the current IASB definition of a liability refers to a present obligation to "transfer an economic resource", whereas the IPSASB definition refers to a present obligation "for an outflow of resources". The IPSASB decided against using the word "transfer" because of its public sector connotations, particularly those related to the financing of one level of government by another and to social benefits.

The IPSASB also considered the definition of ownership contributions and ownership distributions. The IPSASB considered whether the definitions of ownership contributions and ownership distributions should refer to "net financial position" or "resources". Staff considered that a reference to net financial position is inappropriate, because it suggests that there can be an ownership interest in a resource that an entity does not control and that, conversely, an ownership interest may be reduced by an obligation or commitment that is not a present obligation at the reporting date. Staff suggested that net financial position should be replaced by "resources". The IPSASB tentatively decided that the definitions should refer to net financial position. The revised versions are:

- Ownership contributions are inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity; and
- Ownership distributions are outflows of resources from the entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the net financial position of the entity.

The supporting narrative description would be: Ownership distributions may be: a) a return on investment; b) a full or partial return of investment; or, c) in the event of the entity being wound up or restructured, a return of any residual resources.

While the revised and separate chapter discussed uncertainty over the existence of an asset and measurement uncertainty it did not provide explicit recognition criteria, The IPSASB directed staff to include such recognition criteria.

The other main changes directed during the page-by page review were:

- To delete the description of net financial position in the Introduction section and note that net financial position is discussed in section 5;
- To reinsert “necessarily” in the description of “service potential” in paragraph 2.3, so that the description reads “service potential is the capacity to provide services that contribute to achieving the entity’s objectives without necessarily generating cash flows.”
- To reinsert a reference to holding cash in the discussion of economic resources in paragraph 2.5;
- To delete the word “conversely” in the context of “ability to deny or restrict access to the resource;”
- To modify the discussion of taxable event in paragraph 2.8, so that it refers to “the right to receive resources” rather than “an obligation of an external party”;
- To insert a reference to “jurisdiction-specific “ factors in the context of identifying a past event in paragraph 3.4;
- In section three to refer to a “legal binding obligation” rather than just a “legal obligation”;
- In paragraph 3.13(c) to soften the language in the discussion of the availability of funding to settle a particular obligation by removing the presumption that a non-legally binding obligation exists if contingency funding is available or there is a transfer from a different level of government;
- To make the rationale for the decision not to include an analysis of exposure to the risks and rewards of ownership as an indication of control more concise and clearer; and
- In the discussion of commitments and commitment accounting in paragraph BC52 to ensure that there is a conclusion about why commitments are not addressed in the core text.

The IPSASB will review a further version of the draft final chapters at the September 2014 meeting with a view to approval.

Re-exposure

Staff noted that the approach to acknowledge that “other economic phenomena” that do not meet the definition of an element may need to be recognized in order to meet the objectives of financial reporting is a change from the proposal to define “deferred inflows” and “deferred outflows” as elements in the Exposure Draft, Conceptual Framework: *Elements and Recognition in Financial Statements*, and therefore warrants consideration as to whether re-exposure is necessary. Staff noted that, under the current due process, such consideration will take place after the chapter has been approved. Staff said that they will provide an evaluation of the reasons for and against re-exposure at the September meeting.