



**INTERNATIONAL FEDERATION  
OF ACCOUNTANTS**

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**Agenda Item  
2B**

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**Date:** October 13, 2010  
**Memo to:** Members of the IPSASB  
**From:** Nickie Young/John Stanford  
**Subject:** Draft Consultation Paper: The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities—Phase 2: Elements and Recognition

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### Objectives

- To review the Draft Consultation Paper(CP), and where necessary to:
  - **Identify** additional issues for inclusion in the document,
  - **Identify** issues that should be excluded from the draft CP, and
  - **Identify** issues that need to be developed and/or explained more clearly.
- To review the draft Executive Summary and Request for Comments on the CP to **identify** whether the appropriate matters are being raised for constituents.
- To review the draft CP Snapshot document, **identify** improvements to this document, and **decide** on whether it should be included for distribution with the CP or otherwise made publicly available.
- To **approve** the Draft CP, Executive Summary and Request for Comments on the CP, and the Snapshot document.

### Agenda Material

- 2B.1 Draft Consultation Paper
- 2B.2 Draft Executive Summary and Request for Comments on the Consultation Paper
- 2B.3 Draft Consultation Paper Snapshot Document
- 2B.4 Alternative Financial Performance Models

### Background

#### Draft Consultation Paper

1. The Task Based Group charged with responsibility for the Elements and Recognition section of the Conceptual Framework project (TBG 2) met briefly in Vienna on July 1, and again by conference call on September 24 and October 4, 2010. Between July and October, there has been considerable input and communication between the TBG 2 and the lead author. The TBG 2 members are

- David Bean, Tim Beauchamp, Ian Carruthers, Ron Salole, and Ken Warren. Their very significant contributions to this paper are acknowledged and appreciated.
2. Based on input received from the IPSASB at its June/July 2010 meeting, TBG 2 has developed an updated draft of the Consultation Paper on Elements and Recognition. An earlier draft was distributed in August to members of the Standards-Setters Advisory Panel (SSAP), and considerable feedback was received from this group. Their feedback was very useful and also very much appreciated.
  3. In Vienna, IPSASB directed the TBG to develop a position-neutral paper, to more clearly explain the two conceptual approaches to the measurement of financial position, and to address additional specific issues. These directives have been addressed in the draft CP.
  4. The paper begins by setting out the context for general purpose financial reporting by public sector entities and the Phase 2 Elements and Recognition of the Conceptual Framework project. Because there is general agreement on defining assets and liabilities (financial position) in terms of resources and obligations, these elements are addressed first. Possible specific characteristics of the elements are set out and the related issues are discussed with a view to determining which characteristics might be considered essential by public sector stakeholders.
  5. The critical issue of what is meant by financial performance is addressed next, leading into a discussion of the revenue and expense elements. Based on input from IPSASB in Vienna, the conceptual approaches underlying the two major views of financial performance (an asset and liability-led approach and a revenue and expense-led approach) are now more fully explained and examples are provided. The implications of basing revenue and expense definitions on each view are identified. The decision on the meaning of financial performance has fundamental implications for whether deferred outflow and deferred inflow elements need to be identified and defined for the statement of financial position.
  6. The next section of the CP addresses other possible elements that could be identified, including deferred outflows and deferred inflows. The paper then sets out element recognition issues that need resolution.
  7. Seven appendices are provided that support the discussion throughout the paper. It should be noted that Appendix A, “Reporting of Public Sector Entity Financial Information,” remains a work in progress at this date. This decision chart will be discussed at the meetings in Jakarta.
  8. At the November 2010 meeting, the individual Members of TBG 2 will lead the discussion on key issues in each section of the draft CP. This follows the approach adopted at the June meeting in Vienna.

Opening comments – Nickie Young

Section 1 Introduction to Elements and Recognition – Ian Carruthers

Section 2 Assets – Ron Salole

Section 3 Liabilities – David Bean

Section 4 Financial Performance, Revenue and Expense – Ken Warren

Section 5 Other Potential Elements – Ken Warren

Section 6 Recognition – John Stanford

## Next Steps

9. The IPSASB Conceptual Framework work plan indicates that the Consultation Paper on Phase 2: Elements and Recognition is scheduled for approval at the November 2010 meeting of IPSASB. The Consultation Paper is designed to solicit input on issues related to elements and recognition from a broader group of interested parties useful for the development of a draft Exposure Draft for Phase 2 of the Conceptual Framework. The key issues and actions required of IPSASB in Jakarta to move toward this goal are identified below.

## Key Issues

### Key Issue 1: Completeness of Issue Discussion

*Action Requested:*

TBG 2 seeks the IPSASB's views on whether the discussion of the issues in each section of the CP is complete. More specifically, for each of Sections 1 to 6:

- Are there additional issues that need to be identified and addressed?
- Does the discussion of any of the issues addressed need to be expanded?
- Are there issues addressed that need to be clarified?
- Are there issues addressed that need not be included in the CP?

### Key Issue 2: Clarity of discussion about financial performance

*Action Requested:*

TBG 2 seeks the IPSASB's views on whether the discussion about financial performance including descriptions and examples of the two conceptual approaches is explained at a satisfactory level in Section 4 of Agenda Item 2B.1, and whether it is useful and links to the discussion of elements that follows.

10. One of the most important issues that affects the definitions of the elements is the concept of financial performance. This requires input from constituents about whether an asset and liability-led or a revenue and expense-led approach should underlie financial statements, and these two approaches are discussed in Section 4 of Agenda Item 2B.1. In addition, supplementary information will be provided in a separate paper on the IPSASB web site entitled 'Alternative Financial Performance Models' about four current financial reporting models based on one or other of the two conceptual approaches. A draft copy of this paper is included as Agenda Item 2B.4. While this supplementary information was previously

included as an Appendix in earlier versions of the Draft CP, it has not yet been finalized by the TBG 2 as a stand-alone document.

### **Key Issue 3: Executive Summary and Request for Comments on the Consultation Paper**

11. Because the objective of the CP is to elicit input from the broader community about their views on particular issues related to element definition and recognition, it is important that the matters on which they are asked to comment are appropriate to this purpose. The Executive Summary and Request for Comments on the Consultation Paper is set out in Agenda Item 2B.2.

*Action Requested:*

TBG 2 seeks the IPSASB's approval of the Executive Summary and Request for Comments on the Consultation Paper document. Please consider whether the "Specific Matters for Comment" within each section of the CP are likely to elicit appropriate responses from the broader community from which to inform the development of an Exposure Draft on Phase 2: Elements and Recognition.

### **Key Issue 4: Snapshot Document**

12. The CP is a lengthy document, and one that covers many issues of some complexity. Also, because it takes a position-neutral approach, it is not possible or appropriate to provide a sense of the Board's likely direction through the paper. The TBG 2 determined, therefore, that it would be useful to readers to have a covering "snapshot" of the document that provides an overview of the issues the CP addresses. The objective is to enable the document to be more accessible to a wide audience. A proposed Snapshot document is provided in Agenda Item 2B.3.
13. Both the Staff and other TBG members acknowledge the initiative of Ken Warren in recognizing the need for such a document and developing the prototype.

*Action Requested:*

TBG 2 asks the IPSASB to review Agenda Item 2B.3, identify possible modifications to both its substance and structure, and approve the release of this companion document with the CP.

## **GENERAL INTRODUCTION TO THE CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES**

### **Introduction**

The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the Conceptual Framework) will establish and make explicit the concepts that are to be applied in developing IPSASs and other documents that provide guidance on information included in general purpose financial reports (GPFs).

IPSASs are developed to apply across countries and jurisdictions with different political systems, different forms of government and different institutional and administrative arrangements for the delivery of services to constituents. The IPSASB recognizes the diversity of forms of government, social and cultural traditions, and service delivery mechanisms that exist in the many jurisdictions that may adopt IPSASs and has developed this Conceptual Framework to respond to and embrace that diversity.

### **The Accrual Basis of Accounting**

The IPSASB encourages public sector entities to adopt the accrual basis of accounting. This Exposure Draft deals with concepts that apply to general purpose financial reporting (hereafter referred to as financial reporting unless identified otherwise) under the accrual basis.

Under the accrual basis of accounting, transactions and other events are recognized in financial statements when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate.

Financial statements prepared on the accrual basis inform users of the financial statements of past transactions involving the payment and receipt of cash during the reporting period, obligations to pay cash or sacrifice other resources of the entity in the future and the economic resources of the entity at the reporting date. Therefore, they provide information about past transactions and other events that is more useful to users for accountability purposes and as input for decision making than is information provided by the cash or other bases of financial reporting.

The IPSASB recognizes that in many jurisdictions governments and other public sector entities currently adopt the cash basis of accounting (or a near-cash or modified-cash basis of accounting). The IPSASB will consider the concepts that underpin the cash basis of financial reporting after it has developed the Conceptual Framework for the accrual basis.

### **Project Development**

The development of this Conceptual Framework is a collaborative project that the IPSASB is leading in conjunction with a number of national standards setters and similar organizations with a role in establishing financial reporting requirements for governments and other public sector entities in their jurisdictions.

Many of the IPSASs currently on issue are based on International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB), to the extent that the requirements of those IFRSs are relevant to the public sector. The IPSASB's strategy and operational plan also includes maintaining the alignment of IPSASs with IFRSs where appropriate for the public sector.

The IASB is currently developing an improved Conceptual Framework for private sector business entities in a joint project with the Financial Accounting Standards Board (FASB) of the USA. Development of the IASB's Conceptual Framework is being closely monitored. However, development of the IPSASB's Conceptual Framework is not an IFRS convergence project, and the purpose of the IPSASB's project is not simply to interpret the application of the IASB Framework to the public sector. The purpose of the IPSASB's Conceptual Framework project is to develop concepts, definitions, and principles that respond to the objectives, environment and circumstances of governments and other public sector entities and, therefore, are appropriate to guide the development of IPSASs and other documents dealing with financial reporting by public sector entities.

The concepts underlying statistical financial reporting models, and the potential for convergence with them, will also be considered by the IPSASB in developing its Conceptual Framework. The IPSASB is committed to minimizing divergence from the statistical financial reporting models where appropriate.

### **Consultation Papers and Exposure Draft**

Although all the components of the Conceptual Framework are interconnected, the project is being developed in phases. The components of the Conceptual Framework have been grouped, and are being considered in the following sequence:

Phase 1 – the objectives of financial reporting, the scope of financial reporting, the qualitative characteristics of information included in GPFs, and the reporting entity and group reporting entity;

Phase 2 – the definition and recognition of the “elements” that are reported in financial statements;

Phase 3 – consideration of the measurement basis (or bases) that may validly be adopted for the elements that are recognized in the financial statements; and

Phase 4 - consideration of the concepts that should be adopted in deciding how to present financial statements and other components of GPFs.

The project initially involves the development and issue for comment of Consultation Papers to draw out key issues and explore the ways in which those issues could be dealt with. The Consultation Paper dealing with Phase 1<sup>1</sup> was issued in September 2008 and an Exposure Draft was released in November 2010. Consultation Papers on Phase 2 and Phase 3 are being released at the same time, and a Consultation Paper dealing with Phase 4 is under development.

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<sup>1</sup> Consultation Paper “*Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: The objectives of financial reporting; The scope of financial reporting; The qualitative characteristics of information included in general purpose financial reports; The reporting entity.*”

It is the IPSASB's current intention to issue EDs dealing with each of Phases 2, 3 and 4 of the Conceptual Framework after consideration of responses to the Consultation Papers dealing with those Phases. The process for developing the finalized Conceptual Framework will be determined in light of the responses received to Consultation Papers and EDs, and is intended to include issue of an umbrella exposure draft of the full Conceptual Framework.

**DRAFT CONSULTATION PAPER**  
**THE CONCEPTUAL FRAMEWORK**  
**FOR GENERAL PURPOSE FINANCIAL REPORTING**  
**BY PUBLIC SECTOR ENTITIES—PHASE 2**  
**ELEMENTS AND RECOGNITION**

**1 Introduction to Elements and Recognition**

- 1.1 This Consultation Paper (CP) discusses issues associated with the elements of general purpose financial statements (GPFS) of public sector entities and their recognition. Elements are the basic building blocks of financial statements needed to meet the information needs of the users of those financial statements. This CP considers both how these elements might be defined and what criteria might be established for their recognition.
- 1.2 This CP is in Phase 2 of the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities. It builds on and is intended to be read within the context established in the Exposure Draft of Phase 1 of the Conceptual Framework, as well as the ‘General Introduction to the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities’ and the introduction to the ‘Key Characteristics of Government and the Public Sector’ which is included with this CP as a separate document.
- 1.3 The objectives of financial reporting by public sector entities are to provide information about the reporting entity useful to users for:
- Accountability purposes; and
  - Decision making purposes.
- 1.4 Users need information that will enable them to form judgments about such matters as (a) the extent to which the entity has discharged its responsibilities in safekeeping and managing public resources, (b) whether resources have been efficiently and effectively used in the delivery of services, and (c) compliance with relevant budgetary, legislative, and other controls regulating the raising and use of public monies. The discharge of accountability and the provision of decision-useful information about financial position and performance require information beyond that contained in financial statements.

**General Purpose Financial Statements within General Purpose Financial Reporting**

- 1.5 To meet the objectives of financial reporting, information is needed that encompasses financial and non-financial information, prospective financial and non-financial information and reporting on compliance. Accordingly, General Purpose Financial Reports (GPFR) include financial statements; other information about financial condition, and financial performance information on the long-term sustainability of the public finances; as well as non-financial information concerning the accomplishment of objectives.

1.6 The financial statements, however, are focused on the financial portrayal of past transactions and events which affect financial position at a point in time and financial performance for a specified period. A diagram identifying the decisions needed to determine where specific information is best reported is included in this CP as Appendix A.

**The Need for and Nature of Elements**

1.7 Elements are the basic building blocks from which traditional financial statements are constructed. These building blocks provide a common starting point for recording, classifying and aggregating economic phenomena in a way that enhances a user’s understanding of the detailed data contained in an entity’s financial reporting system. Because financial statements are representations of the effects of numerous transactions and events, they necessarily involve a high degree of summarization and classification.

1.8 Elements of financial statements are designed to provide useful categories of information necessary for measuring financial position and financial performance. Their definitions are important because they reflect these relevant measures.

1.9 Elements are the broad classes of items that share the same characteristics (such as assets), not the individual items themselves (such as cash). Discipline is required in identifying what the elements are by limiting the number of elements to the most basic distinctions that are essential for the intended purpose of measuring financial position and financial performance. While sub-classifications of individual items within an element (e.g., cash, receivables, property, equipment, and intangibles as assets) and aggregations or combinations of elements (e.g., combining revenue and certain expenses to show gross margin) may enhance the understandability of the financial statements, issues of display and presentation are separate matters addressed in Phase 4 of the Conceptual Framework project on Presentation and Disclosure.

**Elements to be Considered**

1.10 Elements identified in the reporting models of current standards-setters include:

Elements	Public sector standards-setter					Private sector standards-setter						Both	GFS	
	IPSASB	Can PSAB	SA ASB	US FASAB	US GASB	IASB	Can AcSB	US FASB	US FASB NFP	UK ASB	UK ASB PBE	Aus ASB		NZ FRSB
Assets	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Deferred Outflow					X									
Liabilities	X	X	X	X	X	X	X	X	X	X	X	X	X	X
Deferred Inflow					X									
Net Assets/Equity	X		X	X	X	X	X	X	X	X	X	X	X	X
Contributions from Owners								X		X				

Distributions to Owners								X		X	X			
Revenues/Income	X	X	X	X	X	X	X	X	X			X	X	X
Gains								X	X	X	X			
Expenses	X	X	X	X	X	X	X	X	X			X	X	X
Losses								X	X	X	X			
Other economic flows														X
Comprehensive Income								X						

- 1.11 From this summary, there appears to be general agreement that there are at least four key elements: assets, liabilities, revenues and expenses. One standards-setter has identified deferred outflows and deferred inflows as separate elements. The IPSASB observes, however, that deferred revenues and deferred expenses are a feature of financial statements in many jurisdictions. A key issue is whether such items should be defined as separate elements with consequences for the definitions of other elements. This depends on views regarding the approach to reporting financial performance.
- 1.12 The CP begins by exploring issues related to the necessary characteristics of assets (Section 2) and liabilities (Section 3), the major components of financial position. It then explores different views of financial performance, and based on that, discusses the characteristics of revenues and expenses (Section 4). Other possible elements are then identified that may be needed to provide a complete set of financial statements (Section 5). The issues associated with recognition criteria are then discussed (Section 6).

## 2 Assets

### Overview

This section begins by explaining what information is needed by users of traditional financial statements about a public sector entity's financial position. It then sets out why assets are a necessary element of financial statements, and, by discussing a number of potential characteristics of assets, tries to elicit input about which characteristics are essential to an asset's definition.

- 2.1 Users of a government's financial statements need the statement of financial position to assess the state of a government's finances at a point in time. The statement is useful for this purpose because it portrays the financial and operating capacity of the entity, represented by the resources of the entity and claims on those resources at the reporting date. Such information facilitates assessments of the entity's financial viability, future tax and revenue requirements, and ability to maintain and expand the level and quality of its services. The net financial position provides a measure of the amounts available for future operations or, alternatively, the net amounts needed in the future. The conceptual framework describes these resources and claims on the resources as assets and liabilities.
- 2.2 Assets of a government or other public sector entity are a key element of the entity's financial position. The providers of resources and recipients of goods and services (financial statement users) are interested in assessing whether the entity's assets are managed efficiently and effectively in the provision of public goods and services, and therefore asset definition and recognition also play an important role in reporting on financial performance. Users seek to understand the effects that decisions to retain, use or sell the entity's resources have on current and future resources available to provide public goods and services.

### The Essential Characteristics of an Asset

- 2.3 An asset can be defined in terms of its essential characteristics. If any one of the essential characteristics is lacking, an item would not qualify as an entity's asset. The analysis that follows identifies three classes of characteristics necessary for a complete definition of an asset—those that relate to:
  - (a) The substance of an asset,
  - (b) How to determine if it is the reporting entity's asset, and
  - (c) How to determine if it is an asset at the reporting date.
- 2.4 The classes of characteristics are inferred from definitions developed by a variety of standards-setters that establish accounting standards in both the public and private sectors, as set out in Appendix B. The complete element definition is usually made up of a short definition supplemented with guidance that more fully explains the meanings of the terms used.

### **Substance of an Asset**

- 2.5 The view of an asset as a resource is consistent with the economic concept of a “stock.” The focus is on the resource. The resource generates the flow of future benefits to the entity and services to be provided by the entity.
- 2.6 Referring to an asset as a “stock” implies that the resource has physical substance; however, physical form is not a necessary condition. Many assets, such as buildings and inventories, are tangible. However, items such as patents and mineral rights are not. While categorizing assets between those that have physical form (tangible assets) and those that do not (intangible assets) may provide useful information to users of financial statements, both may be resources.
- 2.7 The benefits provided by a property can be distinguished from the property itself. Some resources embody rights to a variety of benefits: the right to use the resource to provide services; the right to convert it into cash and benefit from its capital appreciation; and the right to a stream of cash flows generated from its use, for example. Other resources may be rights to single economic benefits.
- 2.8 These benefits are sometimes described as economic, but use of this term can be problematic. If by “economic” the notion of scarcity is conveyed, then the term is more likely to be appropriate and useful in the public sector context. However, if by “economic” the notion of profitability or cash benefit is conveyed, then the term is not likely to be useful in the public sector context. This use of the term fails to encapsulate non-cash generating resources that are nonetheless critical to a fair representation of the operating capacity of public sector entities.
- 2.9 Other rights to benefits may not be associated with a particular tangible or intangible resource. An example is the right to require other parties to make payments, or render services.
- 2.10 Public sector entities may share in the benefits embodied in an asset, such as under a joint venture arrangement with another entity. Alternatively, the individual rights can be unbundled, such as in a lease arrangement where one entity, a lessor, may retain the rights to receive rentals and the property’s residual value through disposition, while another entity, perhaps a public sector lessee, has the right to hold and use the asset to provide services in meeting its objectives. Therefore a single property may give rise to assets on more than one entity’s statement of financial position, with each asset having rights to different benefits.
- 2.11 The benefits embodied in the resource may be critical to the definition of a resource.

### *A Resource*

- 2.12 A common view is that an asset is an “economic” resource. An economic resource, by definition, is something of value. In order to embody value as an economic good, there must be some restriction in its availability. Items that are freely available to all, such as the air we breathe, are resources, but they are not economic resources unless they are “scarce.” A natural resource such as water can

meet the definition of an economic resource if it is not freely available or if its supply is limited.

- 2.13 The substance of an asset may be identified in terms of the type of economic benefits provided by a resource. Three potential types of benefits are those in the form of:
- (a) Future service potential,
  - (b) Net future cash inflows, and unconditional promises and other abilities to require provision of resources in the future.

### **Service Potential**

- 2.14 Service potential is defined by the International Valuation Standards Committee in its publication International Valuation Application 3 - Valuation of Public Sector Assets for Financial Reporting (2007) as:

[t]he capacity of an asset to continue to provide goods and services in accordance with the entity's objectives.

- 2.15 Although not included in the final definition, the 2006 exposure draft for this publication continued the definition "...whether those objectives are the generation of net cash inflows or the provision of goods and services of a particular volume, quantity and quality to beneficiaries thereof. In the public sector, the concept of service potential takes the place of adequate profitability applied in the private sector." Although this expanded version is not necessary for the definition of service potential, it does provide additional insight into how the definition might be interpreted.
- 2.16 Other standards-setters have mirrored parts of this interpretation in describing service potential or service capacity:
- (a) A capacity...to provide goods and services capable of satisfying the wants or needs of beneficiaries
  - (b) Provision of means for entities to achieve their objectives but which do not directly generate net cash inflows
  - (c) Capacity of the entity that enables it to provide services or achieve its objectives, enabling it to fulfill its mission
  - (d) The ability to be used, either directly or indirectly, to provide future goods or services to fulfill a need or want of the identified beneficiaries to further the entity's objectives
- 2.17 Public sector assets that exhibit service potential may include recreational, transportation, heritage, conservation, community, defence, social, and administrative structures and items, among others. Such assets are usually held by governments or other public sector entities and provide goods and services, often for general public consumption, in areas where there is no market competition. There may be restrictions on how they are used and on their disposal. Many are specialized in nature. Heritage and conservation resources, for example, are likely to embody service potential to the community in excess of their fair or market-

realisable values. This excess may increase with time, even with a deterioration in their physical condition. They may be irreplaceable and their useful lives are likely to be difficult to determine.

### **Net Future Cash Inflows**

- 2.18 Net future cash inflows from an asset may be derived from:
- (a) its use in the production and sale of goods and services,
  - (b) the direct exchange of the resource for cash or other resources,
  - (c) its use in satisfying a liability,
  - (d) serving as a distribution to owners, or
  - (e) holding cash itself because of the universal acceptance of its command over other resources.
- 2.19 Benefits in the form of net cash inflows apply to resources such as cash, loans and receivables, inventory for resale, and portfolio investments. Also, some public sector resources generate cash flows because they have user fees associated with them. Whether many assets are cash-generating or not at any point in time depends on the choice the public sector entity makes, as it determines what services are tax-supported and what services will be paid for through user fees.

### **Binding Unconditional Rights to Receive Resources**

- 2.20 Another concept of future economic benefits encompasses unconditional promises of others resulting from contracts or other binding arrangements that require provision of resources to the entity in the future, including risk protection. For example, an entity that contracts with an insurance company to unconditionally receive protection against losses incurred by fire damage for the next two years, or contracts with a supplier who promises to deliver a specified quantity of product in the future is perceived as having rights to economic benefits. The future economic benefits are in the form of unconditional risk protection services and the ability to unconditionally require delivery of another economic resource, respectively. Because public sector entities enter into similar contracts and agreements, this form of future economic benefit could be equally valid in defining assets in the public sector.
- 2.21 Both private and public sector entities have supported the inclusion of such unconditional rights as assets to the extent that the entity has paid for the unconditional promise in such a contract or the rights develop a recognized fair value while being held. However, when the unconditional promise to receive benefits is matched with an equal unconditional promise to accept delivery and transfer economic resources to the supplier in the future, neither the asset nor the liability aspects of such executory contracts have generally been acknowledged.
- 2.22 For consistency of application of an asset definition, interpreting binding unconditional rights to receive resources in the future as future benefits, and therefore as resources, perhaps should not hinge on whether payment has been made or whether the entity has a binding obligation to transfer resources in the

future at the reporting date. The existence of all such rights may be relevant information for users

*Terminology*

- 2.23 In describing the benefits that are derived from assets, some public sector standards-setters differentiate between *economic benefits* and *service potential*. In one case, economic benefits are interpreted as resulting in inflows of cash or cash equivalents only, while other assets that deliver goods and services to beneficiaries to help meet the entity's objectives are said to embody service potential. Another standards-setter defines an asset's economic benefits as those resulting in inflows of cash, cash equivalents, goods or services to the government entity itself, and an asset's service potential as benefiting the entity in other ways. Examples include the provision of social, educational, transportation, shelter, or other opportunities at little or no charge to the public or other beneficiaries. Other standards-setters, however, either define service potential as a form of economic benefit or use the two terms interchangeably.
- 2.24 If the potential to provide services is a good that provides benefits either directly to the entity or to its beneficiaries in meeting its objectives, service potential may be considered a subset of economic benefits. Because the entity is transferring goods or services that are scarce in relation to the demand for them (i.e., they are not naturally occurring in abundant supply), and because the goods or services have a value to the entity in furthering its objectives, the service potential embodied in an asset can be considered a form of economic benefit. However, others believe that because a significant portion of government assets are employed to provide service and not to derive an economic benefit, the term "service potential" should be incorporated separately into the definition of an asset. In the remainder of this CP, the term benefit is considered to include both economic benefits and service potential benefits, subject to further input.
- 2.25 Similar to economic benefits that generate net future cash flows, there is no requirement that service potential benefits flow in the immediate future, as long as they are held, and are useful in meeting the objectives of the entity.

**Specific Matters for Comment #1:**

- (a) What term should be used in the definition of an asset:
- (i) Economic benefits and service potential, or
  - (ii) Economic benefits
- (b) The substance of an asset is identified as a resource representing three potential types of benefits—those in the form of service potential, those in the form of net future cash flows (or reduced net cash outflows), and those representing unconditional promises and other abilities to require provision of economic resources in the future. Do you support including all three types of benefits as characteristics of an asset?

### **Asset of the Reporting Entity**

- 2.26 Because the financial statements of a government or other public sector entity can include only its own assets, one of the essential characteristics of an asset has to clarify how an entity determines whether the asset is its asset or not. The issue, therefore, is how to link the rights or other access to the future benefits that are the embodiment of a resource to the specific entity that benefits from them.
- 2.27 An entity can obtain benefits from a resource without it being an asset of the entity. For example, a convention centre owned by an entity at a higher level of government may be located within a municipality's boundary. The hundreds of conventions attracted to the municipality result in increased property assessments and higher tax revenues for the municipality. Does the fact that benefits flow to the municipality make the convention centre an asset of the municipality?

### *Control*

- 2.28 One criterion used to link a resource to a specific entity in the past has been that of control. One standards-setter has defined control of an asset as "the ability of the government to utilize the resource's present service capacity and to determine the nature and manner of use of the present service capacity embodied in the resource." Generally, the government controlling the asset has the ability to determine whether to (a) directly use the present service potential to provide services to citizens; (b) exchange the present service capacity for another asset, such as cash; or (c) employ the asset in any of the other ways it may provide benefit.
- 2.29 For an asset that is provided for use by the citizenry and general public, control is held by the government that possesses the ability to control access to the present service potential embodied in the asset. This control may be demonstrated, for example, by determining the level of service the asset will provide, such as setting hours of operation and fee levels for a public park. Many assets, such as investments of a trust or capital assets purchased with grant proceeds, are subject to legal or other external constraints.
- 2.30 Control also has been defined from an entity perspective. For example, IPSASB has defined control as "the power to govern the financial and operating policies of another entity so as to benefit from its activities." However, it should be noted that the entity definition proposed in Phase 1 of the IPSASB's Conceptual Framework project does not use the term control, so it could be considered in developing the definition of an asset. As part of current consolidation projects, the private sector's definition of control may change to "the power to direct the activities of another entity to generate returns for the reporting entity." The power to direct the activities of the other entity is described as being achieved primarily through voting and/or contractual rights. Recently, private sector standards-setters are considering moving away from the use of the term "control" in determining rights to benefits for asset definition.
- 2.31 The concept of control is difficult to apply because it requires considerable judgment to assess whether control in fact exists, and it tends to be applicable to

entire resources (a unit of account issue), whereas different entities may have an ability or power to direct only some of the benefits and exposures to risks making up a single resource.

*Risks and Rewards*

- 2.32 A common way to access the benefits that an asset provides is through legal ownership of the underlying asset, such as with many accounts receivable or land and buildings. Legal rights to benefits, however, can be obtained without ownership of the underlying property. As indicated above, the rights to the benefits attained by holding and using leased property can be accessed without ownership of the leased asset itself. Therefore, ownership cannot be considered an essential characteristic of an asset because this feature is not always required.
- 2.33 The notions of “economic ownership” and “enforcing ownership rights” have been used by some in place of legal ownership. Economic ownership adopts a “risk and rewards” approach, whereby the entity has rights or access to the majority of the risks and rewards that ownership of that asset would ordinarily entail. As with the concept of control discussed above, the concept of economic ownership is difficult to apply because it requires considerable judgment to assess the relative risks and rewards, and it tends to be applicable to entire resources, whereas different entities may have rights to different benefits and exposures to different risks in the same resource.

*Access to the Rights*

- 2.34 As an alternative, the focus of an asset’s definition could be on the entity’s access to the rights to benefit from the resource in meeting its objectives. If that access exists, the entity can determine the nature and manner of use of the benefits embodied in the resource. These rights can be demonstrated by setting the entrance fee to a museum, for example, or deciding that there will be no such fee. Generally, the entity with the rights has the ability to determine whether to (a) directly use the resource’s service capacity to provide services to beneficiaries; (b) exchange the benefits for another asset, such as cash; or (c) use the asset in any of the other ways it may provide benefits.
- 2.35 The benefit of a “right of access” approach is that it links the asset to the entity in terms of the entity’s ability to access the benefits of the resource. If given too much prominence, however, it could result in a definition of an asset that is too broad. For example, an entity has access to a fiber optic cable, but the cable is not that entity’s asset. Further, the general public has access to many public sector assets, such as museums, but those assets do not belong to the individuals who access them.
- 2.36 The concept of access to rights may be difficult to apply to a historical cost-based model. For example, if a government sells certain rights to an asset, but retains other rights, determining the historical value of the rights that have been transferred and those that have been retained can be problematic.

*Legal or Other Enforceable Claim to Benefits*

- 2.37 Requiring an entity to have a legally enforceable claim to an asset's benefits through contractual rights has also been suggested as a criterion to link the asset to the entity. Legal enforceability can be represented, in addition to holding title to the resource, by being a party to a contractual arrangement as this usually entitles an entity to access such benefits.
- 2.38 The rights to specific benefits offered by a property may be supported by several contractual rights, such as the right of road access over the property, a right to benefit from the land through its agricultural use, and a right to explore for mineral deposits. In this case, the legally enforceable claims to each of the types of benefits could result in an asset to the holder of each specific right. However, an entity may be able to access the benefits associated with a resource in ways other than legal rights. For example, an entity may have developed an unpatented secret process from which it expects to access future benefits. Alternatively, an entity may be able to ensure continuing access to specific rights by imposing effective economic or social sanctions on other parties. Therefore, the requirement for an entity to have a legally enforceable claim in order to control access to the benefits is not considered an essential characteristic of an asset on its own. However, legal enforceability or other effective means of enforcing the rights may be an appropriate indicator for linking a resource and a specific entity.

*Restrict or Deny Access of Others*

- 2.39 In addition to being able to access the benefits, the entity must also be able to control others' access to them by denying, restricting, or otherwise regulating access to the rights. One standards-setter illustrates this by contrasting the examples of outer space and natural resources under government land. The government can obtain benefits from using the outer space resource, but it is not an asset of the government because the government cannot restrict or regulate the access of others. The government also has the benefits of the natural resource under government land, but in this case, the entity is able to regulate and restrict the access of others to the benefits. In this latter example, the natural resource might qualify as an asset of the government.
- 2.40 A government can effectively enforce its benefits related to the electromagnetic spectrum, for example, and has the power to regulate and restrict the access of others to those benefits. Similar arguments can be made for emission rights. While some natural resources, the electromagnetic spectrum, and emission rights may not qualify for recognition as assets in financial statements due to measurement issues, they may still have characteristics that qualify them to be defined as assets.
- 2.41 An entity may not actively exercise its ability to derive benefits from a resource. However, it is the ability, not the actual exercise of that ability that may distinguish whether or not the resource is an asset of the entity.

**Specific Matters for Comment #2:**

- (a) Which approach do you believe should be used to associate an asset with a specific entity:
  - (i) Control
  - (ii) Risks and rewards
  - (iii) Access to rights
- (b) Does an entity's legal or other enforceable claim to benefits or ability to deny, restrict or otherwise regulate the access of others link a resource to a specific entity? Is this an essential characteristic of an asset?
- (c) Are there additional requirements necessary to establish a link between the entity and an asset?

**Asset at the Reporting Date**

- 2.42 The third class of characteristic needed in the definition of the asset element relates to requiring the other required characteristics to be met at the reporting date. Three issues are discussed that relate to this class of characteristic:
- (a) Existence at the reporting date—definition, or recognition criterion
  - (b) Necessity of identifying a past transaction or event
  - (c) Unique public sector rights

*Existence at the Reporting Date—Definition, or Recognition Criterion*

- 2.43 Two different views are held about whether the existence of the required characteristics of the asset at the reporting date should be part of the element's definition, or be identified as a separate recognition criterion. Regardless of positioning, the issue concerns whether a probability threshold should be set on the likelihood of receiving the expected inflows of benefits or whether a firm judgment is required that future benefits do, or do not, exist.
- 2.44 A fuller discussion of existence uncertainty is found in Section 6 of the CP, and questions about a preferred approach are left to this later section.

*Past Transaction or Event*

- 2.45 Most current definitions of assets, as summarized in Appendix B, specify that an asset results from a past transaction or event. Entities normally obtain assets by purchasing or producing them, but other transactions or events may generate assets.
- 2.46 The close association between incurring expenditures and generating assets might be put forward as an essential characteristic of an asset, but the two do not necessarily coincide. Although many public sector assets result from incurring expenditures, not every expenditure incurred gives rise to rights to future benefits.

- 2.47 Those who contend that a past transaction or event is not a necessary condition for an asset point out the following:
- (a) Past transactions or events may have resulted in assets that no longer exist; and
  - (b) The inability to identify a past transaction or event may lead to non-recognition of an asset. Many place undue emphasis on identifying the past event that gave rise to an asset. Although this may be helpful, it may be a distraction and lead to debates about which event is the triggering event instead of focusing on whether the rights to benefits exist at the reporting date.
- 2.48 Some consider that the notion of an asset being a “present” resource is an essential characteristic rather than the requirement for a past transaction or event as in some existing definitions. If a past transaction or other event is not considered to be an essential characteristic, it may be an indicator to provide evidence supporting the existence of a present resource.
- 2.49 Regardless of how this is characterized, the idea is implicit that to be an asset, the benefits embodied in a resource must exist at the reporting date and they must be resources of the entity at that time.

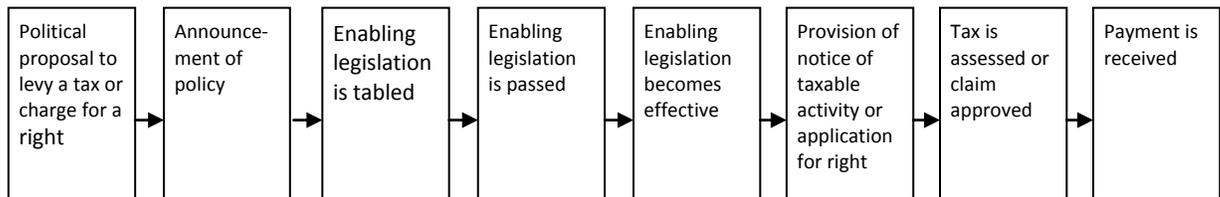
**Specific Matter for Comment # 3:**

Does the existence of an asset depend on the occurrence of a past transaction or event? What other criteria are helpful in determining if a resource is a “present” resource?

*Unique Public Sector Rights or Powers*

- 2.50 Public sector entities acquire assets in a variety of ways. Some significant assets are inherited through such events as conquest, war, or changes in political boundaries. Other assets are created in non-exchange transactions, and by virtue of exercising sovereign powers. The power to tax and issue licenses for example, and other rights or powers to access and to regulate access to the benefits embodied in intangible resources like the electromagnetic spectrum, are rights or powers that others do not have. Given the significant powers that accrue to sovereign governments and other public sector entities, it is often difficult to determine when such rights or powers meet the requirement of being a present resource and an asset of the entity.
- 2.51 Political proposals to exercise the government’s right or power to levy a tax or fee, for example, often begin a sequence of events that ultimately results in cash resources flowing to the government. This is illustrated in the sequence in the diagram below. Note that each step that results in the flow of resources may occur at any time, or may occur incrementally over time. For example, it is common for a government to demand a fee in advance for a right or power that can be exercised over a number of future years (such as electromagnetic spectrum fees) or for indefinite periods (such as a lifetime motor driver’s licence). Conditions

may be contingent on future events or may be fully crystallised early in the process.



2.52 The crucial issue in determining whether the power to tax or license is an asset at the reporting date is one of identifying the conditions that must be satisfied in order for it to be considered a resource of the government at the reporting date. There are at least two views of when such rights are present resources and therefore two views of when there is an asset:

- (a) A government entity's right to future benefits from taxes and fees, for example, is always inherent in the government's power (a rights view).
- (b) A government entity's power to levy a tax or impose fees meets the definition of an asset only when the government has exercised that power by levying the tax or assessing a fee (a power view).

2.53 The first view considers the inherent right to tax as an asset at every reporting date—it is a perpetual asset. The right to tax is a right to future benefits that the entity is able to access and use and limit or preclude others' access at each reporting date. Therefore, such rights meet the definition of a resource. The rights to the future benefits accrue to and are controlled by the government entity at the reporting date, and the entitlement to the rights is enforceable. Benefits can be obtained by assigning such rights to other entities for a fee, or levying the tax directly. This approach is only dependent on the condition that the rights to the benefits exist at the reporting date. It does not require a past transaction or event to have occurred to crystallize the rights as an asset.

2.54 This view is consistent with the rights inherent in an intangible asset being recognized as an asset. At the reporting date there may not be a claim on a specific party based on the asset, but the right of the entity to access and control others access to its future benefits at the reporting date qualify it as an asset of the entity. Under this approach, there is no need to identify the point in the process—such as a political promise or the enactment of legislation—that gives rise to an asset. Although identified as a resource, these rights would still have measurement hurdles to overcome before being included in the financial statements of a government entity.

2.55 The second view holds that the power must be exercised by the government before future benefits are considered to exist. This view relies on an action by the government to evidence the existence of the right of access to the benefits.

2.56 This approach sees the power to obtain additional assets by imposing taxes or licensing fees as necessary but not a sufficient condition for identifying such powers as assets. It holds that although the power to tax, for example, is a means

that can be drawn on, that power is not a right to future benefits at the reporting date without being exercised. In the sequence in the diagram above, the necessary condition would be to the right, that is, when the taxable transaction takes place or a fee is levied.

- 2.57 Supporters of this view do not believe that these powers are consistent with rights inherent in an intangible asset. Those assets are acquired or created by an entity; whereas these powers are inherent to a government. The perpetual nature of most governments presents a recognition issue for those who hold the first view. Supporters of the second view believe that even if the benefits associated with such a power could be measured (for example, a power that is provided for a limited period of time that may or may not be exercised) that power still does not constitute an asset.

**Specific Matter for Comment # 4:**

Recognition and measurement criteria aside, are public sector entity rights and powers such as those associated with the power to tax and levy fees inherent assets of a public sector entity, or are they assets only when those powers are exercised?

**Specific Matters for Comment #5:**

- (a) Are there any additional characteristics that have not been identified that you believe are essential to the development of an asset definition?
- (b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of assets?

### 3 Liabilities

#### Overview

The second key element is liabilities. This section explains why liabilities are a necessary element of financial statements and identifies issues that are related to this element. After discussing their potential characteristics, questions are asked to determine which characteristics are considered essential to a liability definition.

- 3.1 Governments exist to provide a wide range of public services and are responsible for the ongoing provision of health, welfare, safety, education and other services. They offer a number of social programs such as public benefit and public pension programs and public sector entities provide a variety of other goods and services. Public sector operations entail a variety of obligations to others. The point of demarcation between a statement of intent, a commitment, and liability is often not clear and may differ based on the circumstances of the transaction or other event. Without a robust definition of a liability, inconsistencies in the accounting treatment of such obligations can occur.
- 3.2 Public sector entities also react to events such as natural disasters and epidemics to assist those in need. Some have established a pattern of past practice of recognizing obligations related to such events making it difficult to determine whether a government has an obligation when such events occur, or even in the expectation of this type of event.
- 3.3 The way in which programs and services are carried out varies from country to country and often from government to government within a country. Users of financial statements need to understand the effects that past and current operating, financing, capital, and investment decisions and unexpected events have on claims of others to the entity's resources. This, in turn, affects the ability of the entity to provide future programs, goods and services. Therefore, liabilities are a key element of the statement of financial position.

#### The Essential Characteristics of a Liability

- 3.4 One way to define a liability is to identify its essential characteristics. The analysis that follows distinguishes three classes of characteristics necessary for a complete definition of a liability—those that relate to:
  - (a) The substance of a liability,
  - (b) How to determine if it is the reporting entity's liability, and
  - (c) How to determine if it is a liability at the reporting date.
- 3.5 The classes of characteristics are inferred, for the most part, from existing liability definitions developed by current standards-setters. These are set out in Appendix C.

## **Substance of a Liability**

### *An Obligation*

- 3.6 The terms liability and obligation are often used as synonyms, but the existence of an obligation is only one of several essential characteristics that could be used to define a liability. An obligation is generally viewed as a duty or responsibility to act or perform in a particular way to another party.
- 3.7 An obligation may be settled in a variety of ways, usually by giving up something of value to the entity—the transfer or use of cash or other assets, the provision of goods or services or the incurrence of another liability. Obligations may also be settled through conversion of the obligation to a residual claim to the public sector entity's net assets (similar to equity).
- 3.8 Some believe that the primary emphasis should be on the outflow or transfer of benefits, and that the emphasis on the obligation characteristic should be reduced. This position is based on the view that discharging an organizational need has the same effect on an organization's assets as discharging an enforceable claim. From that perspective, it is the outflow of benefits from the entity and not the obligation that takes precedence.
- 3.9 Others believe that the outflow of benefits should not be over emphasized. While settlement by a sacrifice of benefits may be a requirement in most circumstances, it is not always present. A public sector entity, for example, may have a loan payable that is subsequently forgiven by the lender, normally by another government entity; hence there may be no outflow or sacrifice of future benefits. In other cases, a liability may be settled by replacing it with another liability. For example, governments often refinance outstanding debt when it is to their economic advantage (e.g., lower interest rates) or when cash requirements require them to refinance. In these cases, there may be no net sacrifice of benefits. However, in such a situation, two transactions have actually taken place. The entity settles the original obligation and recognizes a new one. If only the terms of the original debt are changed, the entity still has an obligation to transfer resources in the future.
- 3.10 Regardless of how the obligation is satisfied, the entity has an obligation to transfer benefits to another party until it is settled. An obligation can be defined in a number of ways in addition to the more conventional requirement to transfer cash or other assets, or to provide goods and services. Obligations could include the following concepts that are not described in many current definitions of liabilities:
- (a) Unconditional promises, including unconditional promises to stand ready to ensure against loss (risk protection),
  - (b) Performance obligations, and
  - (c) Obligations to provide access to or forego resources in the future.

### Unconditional Promises including Stand-ready Obligations

- 3.11 An *unconditional* promise or other requirement is one that stands on its own, independent of future events. A *conditional* obligation, on the other hand, is one that relies on the possibility of a future event occurring. Those who distinguish between conditional and unconditional obligations do not consider that a conditional obligation gives rise to a liability at the reporting date.
- 3.12 An unconditional obligation includes stand-ready obligations where, although there may be uncertainty about the future outflow of benefits, there is no uncertainty about whether an obligation exists in fact. This includes obligations such as those providing guarantees against loss in case of flood, public sector crop or export receivable insurance obligations, and out-of-the-money derivative contracts. In these examples, because the entity *unconditionally* stands ready to provide resources, these obligations fall within this concept of a liability. The obligation to cover a specific future loss is a *conditional* obligation (contingent on the future occurrence of an insurable loss event) that falls outside the definition of an existing obligation until that future loss occurs.
- 3.13 The requirement for an obligation to be unconditional may be useful in determining whether other obligations, such as those under many executory contracts for example, should be considered liabilities. If a government entity signs a contract for delivery of a given quantity of material to be delivered in the following year, past practice has been to not recognize a liability on the basis that there has been no performance by either party to the contract. This contract could be excluded instead on the basis that it is a conditional contract—one that is contingent on future deliveries as specified. However, a similar contract that entails a “take-or-pay” feature (i.e., the entity takes delivery and pays for amounts under the contract and pays for the contracted amount not taken) would be an unconditional obligation that gives rise to a liability.
- 3.14 Alternatively, issues may arise when applying an “unconditional” promise requirement to conditional liabilities associated with both exchange and non-exchange transactions. For example, a pension obligation with a vesting provision is contingent on future events (employees remaining in the entity’s employ until the vesting period is attained), although there may be a stand-ready obligation to meet that commitment. In addition, governments and other public sector entities, by their nature, stand ready to provide cash or other goods and services under law, regulation or past practice where sectors of the population experience extreme hardship. In the public sector particularly, it may be difficult to draw the distinction between a conditional obligation and a stand-ready unconditional obligation.

### Performance Obligations

- 3.15 A performance obligation is a promise in an agreement between the government or other public sector entity and another party to transfer a resource to the other party. These promises represent performance obligations of the government and are sometimes referred to as “deliverables.”

- 3.16 The promise within a contract or other agreement for a government to provide a service is also considered a performance obligation. The promise underpinning a performance obligation is typically explicitly stated in the agreement itself. For example, a government entity may enter into an agreement to provide community services during the year and the agreement specifies the services it will provide. Such explicit promises within a contract or other agreement generally can be easily identified.
- 3.17 However, a promise may also arise when entering into a contract or other agreement even though the agreement itself makes no mention of the promise. For example, a statutory requirement on the part of the public sector entity is an implicit promise that is added to an agreement between the government entity and the other party. This implicit promise may give rise to a performance obligation just as an explicit promise would. Whether by the explicit terms of a contract or other agreement, or by requirements imposed by legislation, any promise to transfer resources to another party that arises as a result of entering into the agreement could be considered a “performance” obligation of the government.

**Obligations to Provide Access to or Forego Future Resources**

- 3.18 Complexities may arise when the service is to be provided by the other party to the contract and the government grants that party, for a fee, the right to use a government asset that the government continues to recognize. If the services continue to be provided to the government’s constituents as in the past, questions arise as to how and whether a performance obligation associated with the rights granted should be reported. In this situation some believe promising access to the asset could be viewed as a stand-alone performance obligation and liability. In contrast, if no additional promises of performance are provided by the government, the granting of access to an asset that will continue to be used to provide services to the government’s constituents does not require the government to perform. Based on this scenario, others believe that there may be no performance obligation or liability.
- 3.19 As indicated, there is some question as to whether providing a right of access actually entails a transfer of resources and, therefore, an obligation or liability. For example, assume a government entity contracts with a private sector entity to construct a highway, with the government maintaining ownership of the asset. The private sector entity agrees to maintain the highway under a 20-year contract that permits them to charge a toll that will more than compensate them for any maintenance costs. On entering into the contract, the service provider pays a lump sum to the government representing the net value of the contract. What is the public sector entity’s obligation? Is it the requirement to allow the contracting party access to the future benefits of the highway? Many will conclude that the government has no further responsibility or obligation as long as the other party to the contract abides by the terms of the contractual arrangement. Is the obligation the requirement for the government to refrain from charging tolls (netted against the reduction in government-incurred maintenance costs), and therefore to forgo net resources in the future? Governments still have the right to increase taxes, even though they may agree not to levy direct charges for the use of the asset. Is a

- non-competition agreement that is similar in substance an obligation and liability of a public sector entity entering into such a contract?
- 3.20 In addition, accepting the view that a requirement to provide a right of access is a transfer of resources appears to be inconsistent with a rights approach to asset definition, should that approach ultimately be adopted. Under a rights approach, an asset such as the highway is a combination of the rights to the various benefits it provides; such as the rights to access the benefits associated with its service potential over its useful life, the rights to levy fees and generate cash flows from its use, and its residual value when it is no longer serviceable. Because the government entity disposed of the rights to 20 years of the cash flow potential of the road for a lump sum payment under the contract, these rights are no longer held by the public sector entity. In concept, they should be derecognized. Accepting that assets are restricted rights to benefits would require derecognition of the asset rights, not the incurrence of an obligation to supply those rights to another party. Such rights were transferred under the contract. This transaction is similar to the securitization and sale of rights making up an accounts receivable portfolio. In that case, the accounts receivable are broken into their various rights and obligations and only the rights and obligations remaining are determined to be assets and liabilities. In that example, the liability portion relates to costs that remain to be incurred as a result of the contract.

*Settlement Date*

- 3.21 Some believe that including the notion of a settlement date is required for determining whether an item is a liability or a contribution from an owner. They note that while “owners” have claims on the residual interest of an entity, there is no time element involved. Further, there may be some instances where a public sector entity may have created a valid expectation but there is no time element and the public sector entity may be able to put off settlement indefinitely. A claim or obligation that is not payable on demand, on a specified date, or on the occurrence of a specified future event may cast doubt as to whether the item meets the definition of a liability.
- 3.22 Others do not support the need for a settlement date as an essential characteristic. They note cases, such as law suits, where the entity may not know the timing of any settlement. From this perspective, if the existence of a settlement date was identified as a fundamental characteristic, such items would not be classified as liabilities until the settlement date was known. Alternatively, a settlement date with a definition that included “on the occurrence of a specified future event” might alleviate this concern.

**Specific Matters for Comment # 6:**

- (a) Do you agree that the substance of a liability includes being an obligation to transfer benefits, defined as cash and other assets and the provision of goods and services, in the future?
- (b) Obligations could also be interpreted to include unconditional promises, including unconditional promises to stand ready to ensure against loss (risk

protection); performance obligations; and obligations to provide access to resources or forego resources in the future. Do all of these promises and obligations result in obligations for the purpose of liability definition?

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

### **Liability of the Reporting Entity**

- 3.23 A second class of characteristics required in the definition of a liability relates to aspects that link the obligation to the specific entity. The entity is obligated if it is required to bear the obligation, and this obligation is enforceable by legal or equivalent means.
- 3.24 Most current definitions of liability include the phrase “of the entity,” “of a government,” “of the federal government,” “of a particular entity,” and “that the entity controls” to link the liability to a particular entity. Such phrases imply that the entity referred to is the party that has the obligation and that will bear the burden.

#### *Entity’s Duty or Responsibility to Others*

- 3.25 An entity’s duty or responsibility to others is another potential essential characteristic of a liability. Supporters of this characteristic believe that there is a benefit in linking the obligation to the specific recipient entity. They note that obligations are usually documented and the obligations of each party are set out. For example, a construction contract to build a new water treatment facility usually specifies the names of the parties to the contract and the terms and conditions of the agreement. However, it may not be necessary to know the identity of the other party before the time of settlement in order to qualify as an obligation and a liability. For example, a government may have an environmental liability without knowing the identity of the contractor who will be hired to carry out the work.
- 3.26 Supporters of this characteristic also believe that a public sector entity cannot be both the entity that is obligated and the entity to which settlement will be made. The obligation must be to an individual, organization, or other party external to the reporting entity. For example, a government has a policy and a duty to maintain its roads at a specified standard of condition. Until services are performed by others to maintain the road’s condition, the entity has no responsibility to an external party and, therefore, there cannot be a liability. Although uncommon in the public sector, individuals with ownership-type interests acting in their capacity as owners are not considered “other” parties. Under this approach, claims to an entity’s residual interest that are capable of settlement only as a result of actions by the entity, are not obligations or liabilities of the entity.
- 3.27 Others believe that this characteristic is not essential to the definition of a liability. They consider that a discussion of this characteristic is useful only to clarify the definition.

*Legal or Other Enforceability on the Entity*

- 3.28 The absence of a realistic alternative to avoid the obligation is another potential essential characteristic in developing the link between the entity and the obligation. There are several approaches to identifying transactions and other events that would meet this characteristic:
- (a) Legally enforceable contractual, constructive, and equitable obligations
  - (b) Legally enforceable contractual, constructive, and equitable obligations and other constructive and equitable obligations associated with exchange transactions
  - (c) Legally enforceable contractual, constructive, and equitable obligations and all other constructive and equitable obligations from which the public sector entity cannot realistically withdraw
- 3.29 The **first approach** uses legal enforceability to determine whether an entity has no realistic alternative to avoid the obligation. Many liabilities arise from contractual obligations resulting from deliberate actions of the entity, such as exchange transactions with other parties. For example, borrowing cash requires an entity to repay the amount borrowed; acquiring assets on credit obligates an entity to pay for them. These obligations are based on written or oral agreements that set out the requirement to transfer cash or other assets, or to provide services to specified or determinable other parties. In other cases, an entity has the ability to make choices, judgments or decisions. For example, budgeting for the purchase of a fire truck and commitments for future ongoing program expenditures are possible future obligations that a government can avoid through its own actions. The entity is not bound to a particular course of action. It has the discretion to change or avoid the possible future obligation through its own actions.
- 3.30 Legally enforceable obligations include those that are established by contract or that are otherwise enforceable by a court of law. In some cases, constructive obligations – those that are created, inferred, or construed from the facts in a particular situation – may also be enforceable by the operation of various legal doctrines. Such doctrines can be considered part of law and thus, are also legally enforceable. In some jurisdictions, equitable obligations—those that stem from a duty to another entity to do that which an ordinary conscience and sense of justice would deem fair, just, and right – might also be legally enforceable when they are supported by courts of equity. Such courts resolve disputes between parties through principles of fairness and justice.
- 3.31 Legal obligations of a government entity might also arise from actions taken by others that are binding on it, such as legislative actions (based on statutes such as those requiring income and sales taxes), judicial actions (such as court awards for damages), or executive actions (for example, regulatory requirements or fines). Even if the public sector entity has some discretion in how it responds to that action, as long as the entity is required to take some action that necessitates an outflow of economic benefits, it has an obligation. For example, the entity might have a choice of remedying a breach of legislation or paying a fine. As long as others can legally enforce the action, the entity is obligated.

- 3.32 Supporters of this approach believe that moral compulsion differs in substance from legal compulsion. They believe constructive obligations that are not legally enforceable should not be included in the definition of a liability because of the judgment required in determining if the entity is socially, morally or economically compelled. For example, a government may decide whether it is “compelled” to carry out a program based primarily on economic conditions at one time, and may decide differently under other conditions.
- 3.33 The **second approach** recognizes that, in addition to legally enforceable obligations, obligations arise because of a government's own actions or conduct. In these cases, social, moral, or economic consequences leave the government no realistic alternative to avoid the future sacrifice of resources. Under this approach such additional constructive obligations arise only from exchange transactions. When parties complete an exchange transaction, they do so after evaluating their understanding of what is given and received under the terms of the transaction. This exchange may not be legally enforceable. Examples include obligations in certain circumstances to an employee who has provided services, in part, in expectation that the employer entity will provide a certain level of bonus.
- 3.34 Supporters of this approach believe that once one party has transferred resources to the government, the government has an obligation to fulfill its side of the transaction. Even if the agreement is not legally enforceable, the government may have an obligation due to social, moral, or economic consequences should it not initially fulfill its agreement. The supporters of this approach, however, do not believe that the constructive obligation provisions should be extended to non-exchange transactions because of the significant discretion that exists in the administration of such transactions that are not legally enforceable.
- 3.35 The **third approach** extends the application of constructive obligations to non-exchange transactions from which the public sector entity cannot realistically withdraw. For example, a government entity may announce the terms of a new program, the intended recipients are aware of the program, and they qualify under its terms. In this case, the entity creates a valid expectation among the recipients and a reliance by them on the government meeting its obligation and, as a result, the government cannot realistically withdraw from that obligation. Examples of evidence that support the existence of an obligation might include an announcement of the amount to be provided, the time frame for implementation, and identification of the individuals, organizations, or groups affected by the decision. Intentions and individual items of evidence on their own may not be sufficient to determine whether a government has created a valid expectation. Announcements of decisions and other types of communication must be considered together. Each situation needs to be judged on its own merits, and would likely require substantial guidance to ensure consistent application of this approach.
- 3.36 When the evidence as a whole raises a valid expectation for the entity to perform, the entity cannot realistically withdraw from it. Supporters of the third approach believe that non-exchange transactions should not be treated differently from exchange transaction in linking the entity and the obligation.

**Specific Matters for Comment # 7:**

- (a) Should the ability to identify a specific party(ies) outside the reporting entity to whom the entity is obligated be considered an essential characteristic in defining a liability, or be part of the supplementary discussion?
- (b) Do you agree that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability?
- (c) Which of the three approaches discussed do you support in determining whether an entity has or has not a realistic alternative to avoid the obligation?

**Liability at the Reporting Date**

3.37 The third class of characteristics needed to define a liability relates to requiring the obligations of the entity to be liabilities at the reporting date. Three related issues are discussed:

- (a) Existence at the reporting date—definition, or recognition criterion
- (b) Necessity of identifying a past transaction or event
- (c) Unique public sector obligations

*Existence at the Reporting Date—Definition, or Recognition Criterion*

3.38 Two different views are held about whether the existence of the required characteristics of the liability at the reporting date should be a part of the element's definition, or separately identified as a recognition criterion. This issue centres on whether a probability threshold should be identified for the likelihood of having to transfer benefits to others, or whether a firm judgment is required that the obligation does exist, in fact, at the reporting date.

3.39 Section 6 of the CP provides a fuller discussion of existence uncertainty, and questions about a preferred approach are left to this later section.

*Necessity of Identifying a Past Transaction or Event*

3.40 As with assets, there may be difficulties in requiring the occurrence of a past transaction or event as an essential characteristic:

- (a) The liability resulting from a past transaction may no longer exist.
- (b) The inability to identify a past transaction or event may lead to present obligations not being identified. While an observed transaction or other event might provide a signal that a liability exists, the failure to identify a past event may not negate the existence of a liability at the reporting date.
- (c) In a public sector context, there may be many possible related past events, making it difficult to identify what the key past event is. This approach may deflect the discussion away from whether it is an obligation at the reporting date to determining what the past transaction or event was.

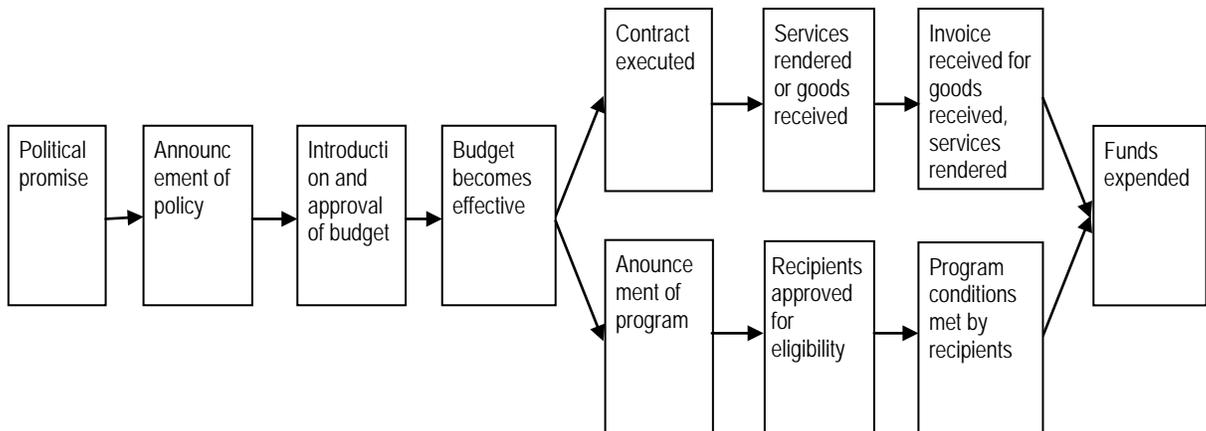
- 3.41 The current definition of a liability developed by most standards-setters includes the requirement that a liability arise from a past transaction or event. Some believe that this characteristic provides additional context and clarification. They believe that, although identifying an obligating event may be difficult, such a past event is essential to the definition of a liability. It eliminates any uncertainty that transactions or other events expected to occur in the future do not, in themselves, give rise to present obligations by making explicit that the event giving rise to the entity's obligation has already occurred. It is a foundation on which any definition should be built.
- 3.42 Describing a liability as a "present" obligation as an essential characteristic in the definition may capture the same intent as the "past transaction or event" requirement in existing definitions. Even if not included as an essential characteristic, the incurrence of a past transaction or event can provide an indication of the existence of a present obligation.
- 3.43 This issue is particularly relevant in the case of executory contracts, where the reporting entity may enter into a non-cancellable obligation—suggesting a present obligation, but the other party has material unperformed obligations—suggesting a future obligation.

**Specific Matter for Comment # 8:**

Is the occurrence of a past transaction or event an essential characteristic of a liability? What other criteria are helpful in determining if an obligation is "present"?

*Unique Public Sector Obligations*

- 3.44 Similar to the issue of when a government's power to levy taxes and impose fees gives rise to an asset, questions arise about when a government's obligations to provide social benefits and programs to citizens and other eligible residents are considered liabilities.
- 3.45 Forming a conceptual basis to determine when public sector obligations give rise to a liability has its challenges. As general government responsibilities and duties become plans, and plans become commitments and then plans are ultimately carried out, the events that unfold can be viewed along a sequence (see below). Preceding the political promise at the left end of the diagram are general government obligations; at the other is the receipt of an invoice for goods provided or services rendered, or, in the case of a non-exchange transaction, the satisfaction of conditions for payment.



- 3.46 Not all the processes illustrated apply to all transactions or other events. For example, some transactions may not be budgeted, and in some countries the budget must receive two or more approvals such as from the Parliament and from the Ministry of Finance. In addition, not all phases will occur in the same order. For example, an announcement of policy through a specific program may occur after the budget has been approved. However, the sequence does provide a broad overview of how a government's obligations are carried out through the system.
- 3.47 The critical issue in determining whether general government obligations are liabilities at the reporting date is the identification of the conditions that must be satisfied in order for there to be no realistic alternative to avoid the obligation. Three views are discussed:
- (a) A government's responsibilities are perpetual obligations.
  - (b) A government's responsibilities are considered obligations of the entity only when they are enforceable claims.
  - (c) A government may have sovereign power to unilaterally avoid the outflow of resources.

### **Perpetual Obligations**

- 3.48 One view holds that, similar to the power to tax being a perpetual asset, the inherent responsibilities of governments result in the existence of perpetual obligations. A government cannot avoid its obligations to provide security, education, health and other services to its citizens. These obligations require the transfer of resources (cash, other assets, goods and services) in the future. Although not contractual in form, they are constructive obligations in nature, and the government has no realistic alternative to avoid these obligations. This view would not require the occurrence of a past transaction or event in order for the obligation to meet the definition of a liability.
- 3.49 At the reporting date there is no claim to the entity's resources by a specific party, however, future events will crystallize the timing and the claimants. This is analogous to other types of recognized obligations such as retirement health care and environmental obligations. Under this approach there is no need to identify

the point in the process—such as meeting the stipulations for a grant—that gives rise to a liability, and, as such, a liability would exist far to the left on the diagram above. If they are defined as liabilities, these obligations would likely encounter measurement hurdles before being included in the financial statements of a government entity.

### **Obligations only when Enforceable Claims**

- 3.50 The second view holds that the parties to whom the obligations are made must be able to enforce their claims through legal or other means. The parties may be specific individuals or organizations, or groups of individuals or organizations who can legally justify their claims on some basis such as contractual, constructive or moral grounds.
- 3.51 This approach sees the obligation to transfer resources as necessary but not a sufficient condition for identifying such responsibilities as liabilities. It holds that enforceability occurs only when events have occurred that obligate and commit the government to act in a particular way. Under this view, an obligation would meet the definition of a liability only towards the right-hand side of the diagram above.
- 3.52 The unique role of the budget for some government entities may play a part in determining if an obligation exists. The budget may be developed based on stated management policies, approved by the legislature, and it, along with the policies and programs, may have the force of law or regulation when the budget becomes effective. Does the approval of the budget transform such plan, policies and programs into enforceable obligations at the date the budget is approved?
- 3.53 Although the program is enacted and spending has been approved, the question arises whether the government at this point has an enforceable obligation to parties outside the entity. If programs will be carried out through exchange transactions, agreements with parties external to the entity may not have been entered into and therefore, legally enforceable obligations may not exist. To the extent the programs will be carried out through non-exchange transactions, the conditions required of others external to the entity may not have been met at the reporting date; or the reporting entity may unilaterally be able to deviate from the plan by organizing its activities in a different way.
- 3.54 Accepting legislatively-approved budget items for all policies and programs as liabilities may be tantamount to defining all budgetary appropriations as liabilities. Some might consider that this would be similar to recognizing as liabilities obligations the entity has to itself, or to those with a residual interest in the entity, i.e. the general public.
- 3.55 What gives rise to a liability at the reporting date may depend on the facts and circumstances associated with the particular situation. In most exchange transactions an obligating action can be clearly identified. In this case, and as captured in the “services rendered or goods received” box in the diagram above, the obligation becomes legally enforceable when the underlying exchange takes place, that is, on receipt of the goods or services.

- 3.56 Identifying the event that gives rise to an enforceable obligation for non-exchange transactions by a grantor government is more difficult. When a government entity agrees to provide assets or services to an individual or other entity under certain conditions, and those conditions have been met, the government has a duty and a present obligation. This is portrayed in the “program conditions met by recipients” box in the time line above.
- 3.57 If the entity has agreed to provide assets or services and there are no conditions imposed, the legal or other enforceability of the obligation at the reporting date comes into play in determining if the entity has a liability. An enforceable obligation may not exist if the government has a realistic alternative to avoid the transfer of benefits. Identification of the points when obligations crystallize is often problematic and relies on the principles underlying the liability definition and the exercise of judgment.
- 3.58 The recipient public sector entity in a non-exchange transaction also must resolve the issue of when it has a liability related to assets and other benefits received under laws, regulations or other binding agreements. Such non-exchange transfers often impose stipulations on the recipient entity. Stipulations have previously been defined by IPSASB as terms in law, regulation, or other binding arrangement that are imposed on the use of the benefits transferred to another entity or individual. Some stipulations require the return of the benefits transferred if the recipient does not comply with the terms of the agreement, while others do not require their return. When does a recipient entity have a liability related to the assets transferred?
- 3.59 Some argue that an obligation exists in the recipient entity from a non-exchange transaction when conditions imposed on the transferred resources have not yet been met. This position is clouded by the fact that each stipulation must be analyzed to determine its underlying substance—whether it implies a return obligation. Enforceability has to be considered, making agreement on the level of enforceability as discussed previously an important consideration in the definition of a liability.

*Sovereign Power to Avoid an Obligation*

- 3.60 Some suggest that sovereign power—the ultimate authority of a government to make, amend, and repeal the legal provisions—enables a government to walk away from any of its obligations, including social benefit obligations.
- 3.61 The existence of such a power introduces complexity to the discussion of which obligations should be defined as liabilities. While the existence of this right alone may influence the “legal enforceability” condition, it is not reasonable to exclude all obligations as liabilities on this basis. Any discussion supporting the definition of a liability, at a minimum, should specify what underlying assumption is made about this specific power of government. One approach may be to base the determination of whether a liability exists by reference to the legal position at the reporting date rather than whether sovereign powers may give it the absolute or conditional ability to repudiate an obligation.

**Specific Matters for Comment #9:**

- (a) Recognition and measurement criteria aside, are a public sector entity's obligations such as those associated with its duties and responsibilities as a government, liabilities of the entity?
- (b) Is the enforceability of an obligation through legal or other means an essential characteristic of a liability?
- (c) Do you agree that any discussion of liabilities must include an assumption about the role that sovereign power plays in that definition, such as by reference to the legal position at the reporting date?

**Specific Matters for Comment # 10:**

- (a) Are there any additional characteristics that have not been identified that you believe are essential to the development of a liability definition?
- (b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of liabilities?

## **4 Financial Performance: Revenue and Expense**

### **Overview**

This section begins by setting out two approaches to measuring financial performance, including the effect of each on financial position elements. The section then addresses specific issues associated with revenue and expense definitions. Choices of potential essential characteristics are identified with the most critical—whether the elements are based on revenue and expense-led or asset and liability-led definitions—discussed first.

### **Approaches to Reporting Financial Performance**

- 4.1 Governments and other public sector entities raise resources from taxpayers, service users, and other resource providers, to help provide services to citizens and other service recipients for a variety of social and economic purposes. The entities are accountable to those who provide them with the resources, and to those who depend on them to use the resources to deliver necessary services and fulfil existing obligations.
- 4.2 To fulfil the accountability objective and meet user needs for information for decision-making purposes, financial statements need to provide information about both financial position and financial performance:
  - The amount and type of resources raised by a government or other public sector entity during the reporting period, the resources available to support future operations, and the obligations to be met in future periods; and
  - The amount and type of resources used in the provision of services, the acquisition of capital assets, the repayment of debt or for other purposes.
- 4.3 Users of financial statements are interested in the financial performance of the entity's management over the reporting period. The statement of financial performance is used to gain an understanding of the sources, allocations and consumption of resources and claims to the resources administered by the entity during the period. Such information facilitates assessments of the entity's resource requirements, the purposes to which resources were used and the nature and extent of its revenue raising activities. The net results over the period provide a measure of whether the revenues recognized were sufficient to meet the costs incurred during the period.
- 4.4 Two different conceptual views underlie what is meant by financial performance and, therefore, different definitions of the elements related to financial performance and financial position may result. One approach measures financial performance as the net result of all changes in the entity's resources and obligations during the period (asset and liability-led view), while the other measures financial performance as the result of the revenue inflows and expense outflows more closely associated with the efforts of the current period (revenue and expense-led approach).
- 4.5 Different approaches to financial performance result in different definitions of revenue and expense elements. This, in turn, may suggest the need to define other

financial position elements. While hybrid approaches that contain attributes of both conceptual views can be developed either through element definition or financial statement presentation (as explained in Sections 4 and 5), the “pure” forms of the two views are first explained and illustrated, and the advantages of each are identified.

- 4.6 The proponents of both approaches equally support the importance of the statement of financial performance in meeting the objectives of GPF. Neither refutes the position that financial performance excludes transactions with owners, and neither approach is directly associated with particular measurement choices.

*Revenue and Expense-led (R&E) Approach*

- 4.7 Under this approach, revenues and expenses are identified and defined as the primary elements—basically as flows that relate to the efforts of the current period. Assets and liabilities are then subsequently defined to include items that are considered not to be related to the current period’s performance as well as items that are resources and obligations.
- 4.8 Financial performance under this approach is measured based on flows that relate directly to current period operations. This requires the deferral of some flows and the recognition of deferred items (deferred inflows and deferred outflows) on the statement of financial position. This view, then, sees accounting as a process of allocating inflows and outflows to particular periods. The principal building blocks of such a system are events, transactions and the resource flows that they entail rather than resources and obligations.
- 4.9 A public sector application of this approach attributes the costs of services to the period in which the services are provided, and attributes tax and other revenue to the period in which they were intended to finance the related costs. Users of financial statements are then able to assess whether the taxes and other revenues recognized in the period were sufficient to finance the recognized costs of providing programs and services during that period.

*Asset and Liability-led (A&L) Approach*

- 4.10 Under the A&L view, assets and liabilities are identified and defined first—basically as resources and obligations. Revenues and expenses are then defined as the result of changes in assets and liabilities. In fact, assets are the starting point for determining all of the other elements, as liabilities are defined with reference to being claims on assets.
- 4.11 This approach views financial performance as the change in net financial position over the reporting period. All items that represent increases or decreases in the recognized net resources of the entity between financial reporting dates are included in this measure.
- 4.12 In order to give meaning to financial performance and, therefore, to the elements comprising financial performance, the elements constituting financial position—assets and liabilities—must first be given meaning. For this reason, assets and liabilities are the principal building blocks of such a system and they are defined

in terms of resources and obligations; that is, in terms of real economic phenomena. Revenues and expenses are then defined in terms of changes in the net resources.

*Illustrating the Approaches*

4.13 The choice between the two approaches directly affects the elements to be defined and the basis for their definition. This is illustrated in the following examples.

4.14 *Example 1:* In Year 20X1, Government X receives a CU2,000 transfer from a senior government to finance the construction of a public library. The grant requires repayment of the full amount if the funds are not used to construct the library. The library is completed and paid for at the end of 20X2, and is expected to have a 40 year useful life.

The table below illustrates how financial performance and financial position differ under the two approaches to element definition for Government X.

Asset and Liability-led approach

	20X1	20X2	20X3
Statement of financial performance:			
Revenue	-0-	2,000	-0-
Expense	-0-	-0-	50
Surplus (deficit)	-0-	2,000	-50
Year-end financial position:			
Asset	2,000	2,000	1,950
Liability	2,000	-0-	-0-
Net assets (net liabilities)	-0-	2,000	1,950

Revenue and Expense-led approach

	20X1	20X2	20X3
Statement of financial performance:			
Revenue	-0-	-0-	50
Expense	-0-	-0-	50
Surplus (deficit)	-0-	-0-	-0-
Year-end financial position:			
Asset	2,000	2,000	1,950
Liability	2,000	2,000 (deferral)	1,950 (deferral)
Net assets (net liabilities)	-0-	-0-	-0-

4.15 Under the *A&L approach*, Government X reports a CU2,000 liability only until the conditions of the transfer are met. Once met, the entity has no further obligation to the senior government and the CU2,000 is recognized as revenue. This amount is included in the measure of financial performance in 20X2, and is included in the net assets of Government X in the same year. The library asset is a resource, and it continues to be recognized as an asset with its cost allocated to expense for each period it is used to provide services.

1.1 Under the *R&E view*, the CU2,000 inflow from the senior government cannot be associated with Government X operations until 20X3 when the benefits associated with the transfer begin. Because it does not meet the definition of revenue until 20X3, the full CU2,000 inflow is recognized as a liability (in 20X1) or deferred inflow (20X2 and 20X3) until that time on the statement of financial position. The benefits associated with the grant are recognized as revenue and included in the measure of financial performance over the useful life of the asset it helped to finance beginning in 20X3, and the deferred inflow is reduced in the same pattern. Under this approach, the library is recognized as an asset on the basis that it is a resource that will benefit future periods, and its cost is recognized as an expense over the period it is used to provide services.

4.16 *Example 2:* Based on law, on January 1, Year 20X1, 20X2, and 20X3, Government Y levies a property tax of CU100 each for 20X1, 20X2, and 20X3 respectively. In 20X3, the law is changed so that a CU100 tax for 20X4 is levied on December 1, 20X3 instead of January 1, 20X4.

The table below illustrates how the major elements, and the statements of financial performance and financial position differ under the two approaches to element definition.

Asset and Liability-led approach

	20X1	20X2	20X3
Statement of financial performance:			
Revenue	100	100	200
Expense	-0-	-0-	-0-
Surplus (deficit)	100	100	200
Year-end financial position:			
Asset	100	200	400
Liability	-0-	-0-	-0-
Net assets (net liabilities)	100	200	400

Revenue and Expense-led approach

	20X1	20X2	20X3
Statement of financial performance:			
Revenue	100	100	100
Expense	-0-	-0-	-0-
Surplus (deficit)	100	100	100
Year-end financial position:			
Assets	100	200	400
Deferral	-0-	-0-	100
Net assets (net liabilities)	100	200	300

4.17 For the first two years, both approaches report the same amounts for revenues, surplus and net assets. In 20X3, however, the revenue, surplus and net asset amounts differ. Under the *A&L approach*, the full CU200 of 20X3 asset inflows are recognized and reported as revenue. This result is reported because the CU100

- asset inflow related to 20X4 does not result in an obligation that is recognized as a liability at December 31, 20X3. Because the net assets increased by CU200 in the year, that is the measure of financial performance for 20X3.
- 4.18 Under the *R&E approach*, the accounting decision reflects a judgment about the inflows that should be reported on the period's statement of performance. Because only CU100 of the asset inflows in 20X3 are considered attributable to the provision of 20X3 services and programs, the other CU100 asset inflows (for 20X4 services and programs) are recognized as deferrals on the statement of financial position at December 31, 20X3. The measure of financial performance each period therefore represents the net asset inflows over time that are attributable to the period's programs and services.
- 4.19 As the examples illustrate, the two approaches to financial performance and revenue and expense definition result in different items being recognized on the statement of financial position. Therefore, depending on the conceptual view supported, the implications for the statement of financial position are that either:
- (a) Two elements are identified: assets and liabilities as resources and obligations (*A&L led approach*), or
  - (b) Four elements are identified: assets and liabilities as resources and obligations, and deferred inflows and deferred outflows (*R&E led approach*).

These choices will be explored in more detail in Section 5 of this CP.

#### *Advantages of Each Approach to Element Definition*

##### **Revenue and Expense-led Approach**

- 4.20 In the public sector, the budget plays an important role in the accountability cycle of the entity. It is the publicly communicated document against which results are measured, the basis upon which taxes are levied, and the basis for planning the resources needed for the goods and services to be provided for a predetermined period, usually a year. The focus on current operations in the R&E view therefore is seen to increase the relevance of the statement measuring financial performance.
- 4.21 It is argued that, because a public sector entity is accountable for raising revenue and the uses to which it is put, this should be the primary indicator of the financial performance of the entity. Further, the principle that taxpayers pay only for the services they receive and not pass on obligations to future taxpayers should ground any measure of financial performance. The revenue and expense-led view may better align with these features.
- 4.22 Supporters contend that the surplus/deficit is a measure of the entity's and its management's performance. Therefore, measuring revenue and expenses and the timing of their recognition should be the focus of financial accounting. Since revenues and expenses are the key measures of financial performance, net financial position should be determined as a result of this process.

- 4.23 Difficult judgments are required as to whether assets or liabilities presently exist. Examples include resources used under service concession arrangements, the power to tax, legislated responsibilities to provide minimum levels of service, and transfer payments received from other levels of government that include no requirements for repayment for non-performance. Adopting a revenue and expense-led approach may reduce problems associated with some of these issues.
- 4.24 In addition, a statement of financial position that includes deferred items reduces volatility in reported financial performance. Because there is an appropriate allocation of flows to future periods that are not associated with the current period, users can better assess the financial impact of current period services.

#### **Asset & Liability-led Approach**

- 4.25 The predominant thinking behind this view is that the measure of financial performance should be grounded in terms of real economic phenomena. Assets and liabilities represent resources and obligations that can be observed and verified directly. Using asset and liability definitions as anchors imposes limits or restraints on what can be included in assets and liabilities (financial position), and also in the directly related aspect of financial performance. All items that represent changes in the net resources of the entity between the financial reporting dates are included in the measure of financial performance, ensuring a high level of reliability, understandability, consistency and comparability of the information, and resulting in a relevant metric to assess accountability.
- 4.26 Because this view includes all changes in assets and liabilities in one statement and produces one “bottom line” for explaining the change in net assets/net liabilities, it does not require judgment to determine which transactions and events that affect financial position are included or excluded from any specific period’s measure of financial performance. Artificial smoothing of periodic results is avoided. Proponents of the asset and liability-led view argue that unless critical terms such as “applicability to the current period” and “non-distortion” of surplus/deficit can be precisely defined, surplus/deficit calculations that result from other approaches are largely subjective. Past experience and attempts to define revenue and expense independently as the primary foundation of financial statements have proved elusive.
- 4.27 Proponents of this approach also suggest that the need to focus on a public sector entity’s resources such as its physical assets available to provide future services, and obligations to be settled in the future supports taking an asset and liability-led view. For example, because public sector entities function to provide public goods and services, it can be argued that the conceptual underpinning of financial statements should be on the resources available to provide those services, obligations to transfer those resources to others and the net resources available to finance future operations. From this point of view, it is important to determine whether the extent of the resources available for future periods or the obligations arising from past periods have increased or decreased. Measuring financial performance on this basis provides this information.

*Summary*

- 4.28 Regardless of whether an A&L or a R&E-led approach is taken, the asset and liability elements can be defined in the same way (i.e., as resources and obligations). To develop the revenue and expense elements portion of an IPSASB conceptual framework, however, it is necessary to proceed from a view on the concept of financial performance that should underlie financial statements. This decision influences the characteristics that are required in the definitions of revenues and expenses, discussed next, and whether deferred outflows and deferred inflows need to be defined as separate elements.

**Conceptual View:**

Please consider the following conceptual choice. It will be useful in helping you form the basis for conclusions on some of the elements that remain.

Issue: Should the measure of financial performance be based on a process of allocating inflows and outflows to particular periods (a revenue and expense-led approach) or should financial performance be based on changes in the period in the net resources/obligations of an entity (an asset and liability-led approach)? What arguments do you consider most compelling in coming to your conclusion?

**Essential Characteristics of Revenue and Expense**

- 4.29 Revenues and expenses can arise from transactions (whether exchange or non-exchange) and from other events, such as price changes or impairments and their reversal. Some standards-setters refer to the positive results of such transactions and events as “income,” using the term “revenue” more narrowly for specific types of income. This paper uses “revenue” as the broader term. Standards-setters have established definitions of revenue and expense, setting out a number of characteristics in those definitions. These are summarized in Appendix D and Appendix E, respectively.
- 4.30 Recognizing that slightly different terms are used in these definitions, they nevertheless provide a basis for identifying the issues that need to be resolved in determining the essential characteristics of revenue and expense prior to developing a definition of each element. The most critical issue is how revenues and expenses should be associated with the reporting period: an association based on changes in assets and liabilities during the period, or an association with the goods and services provided in the period and the taxes levied and other inflows generated to cover the cost of those goods and services. Other issues that need to be resolved prior to developing satisfactory definitions of these two elements are:
- (a) Whether transactions with residual interest/equity participants should be excluded from the definitions, and
  - (b) Whether revenue and expenses should be restricted to the results of specific activities.

### Association with the Reporting Period

4.31 The first issue is how revenue and expenses should be associated with the reporting period. Are revenues and expenses recognized as flows that are “applicable to” the reporting period or are they a result of flows “during” the period that change the stock of assets and liabilities? Which approach is more appropriate follows logically from the conclusion as to whether a revenue and expense-led approach or an asset and liability-led view should predominate as explained above.

#### *Flows Applicable to the Period*

4.32 Those who support a revenue and expense-led concept of financial performance favour the description of revenues as “applicable to” the period. Applicability to a period for revenue may be defined as follows:

- (a) For *exchange* transactions: when the entity has provided services to the other party pursuant to the exchange
- (b) For *non-exchange* transactions: when the entity has met all eligibility criteria and conditions
- (c) For *other events*: the period in which the event occurs<sup>2</sup>

4.33 For non-exchange transactions such as taxation, the association would be directly with the period in which the taxable events or transactions occur. Other non-exchange revenues and other events could be considered “applicable to” the reporting period on different bases, such as when the benefits (including service potential) transferred were to be used.

4.34 Applicability to a period for expenses can be described as those outflows directly or indirectly associated with the goods and services provided in the period.

4.35 Supporters of this form of associating revenues and expenses with the reporting period separately identify and define deferred outflow and deferred inflow elements on the statement of financial position as outflows and inflows that are not “applicable to” the current period. (Please see Section 5 of the CP.) The statement of financial performance then provides information on the extent to which the costs of current period programs and services were financed by current year tax and other revenues.<sup>3</sup>

4.36 Those who support this approach contend that it results in the most relevant financial performance information to users of the financial statements.

#### *Flows during the Period*

4.37 In contrast, others favour definitions of revenue and expense elements based on asset and liability flows or changes “during” the reporting period. Increases in resources and decreases in obligations during the period that increase net assets

<sup>2</sup> GASB Memorandum; Issue 5, Paper 1, June 2005 Meeting, June 6, 2005.

<sup>3</sup> A fuller explanation of this hybrid Inter-period Equity approach can be found on the IPSASB web site in a document entitled “Alternative Financial Performance Models.”

are considered revenues, while decreases in resources and increases in obligations that reduce net assets during the period are considered expenses.

- 4.38 Supporters of basing revenue and expense elements on asset and liability flows “during” the reporting period prefer the discipline inherent in having the revenue and expense definitions based on real economic phenomena that can be observed and verified directly such as economic resources and obligations. They argue this provides a framework for reporting those elements according to their economic substance, and limits the scope for bias, intentional or otherwise, in the reporting of revenues and expenses. They highlight the potential for preparers to have too much latitude in assigning revenues and expenses to particular periods under other approaches. Accounting conventions such as inter-period equity that require judgment about which flows are “applicable to” a specific period are not compatible with element definitions and recognition criteria that need to be specific in nature.
- 4.39 Those who support this approach contend that it results in the most relevant and reliable measure of financial performance.

**Specific Matter for Comment # 11:**

As indicated above, this fundamental issue determines both how revenues and expenses should be defined, in part, but also whether deferred outflows and deferred inflows are necessary elements of general purpose financial statements.

Should revenues and expenses be determined by changes in net assets (including deferrals) that are “applicable to” the current period, or by changes in net assets (defined as resources and obligations) “during” the current period?

**Exclusion of Transactions with Residual Interest/Equity Participants**

- 4.40 Whether transactions with residual interest/equity participants should be excluded from the definitions of revenue and expense is related to the view of ownership/equity/residual interest in the public sector, discussed later in Section 5 of the CP.
- 4.41 In a model that views such an interest in terms of an equity interest similar to the private sector, contributions intended to be an investment in the initial operating capacity of the entity or subsequently increase it are excluded from revenues and are considered direct ownership contributions. Similarly, distributions intended to reduce operating capacity or those intended to be a return on the owner’s investment are excluded from the definition of expenses.
- 4.42 Some agree that this approach might be appropriate where the net assets/net liabilities are similar to a private sector equity interest. If those holding the equity interest expect to earn a return on the funds invested and the reporting entity is assessed on the returns earned primarily from business-type exchange transactions, contributions from and distributions to equity participants might be excluded from revenues and expenses in order to present the transactions faithfully.

- 4.43 The nature of the transaction may also indicate whether it should be included or excluded from the revenue and expense definition. A residual interest/equity participant may be a customer of the reporting entity, and the transaction may be an exchange transaction in the nature of revenue. For example, a water or power utility in a community may supply its related municipal government with water or electricity on the same basis as it supplies these services to other customers. In such a case, and to the extent that the terms of the transactions are reasonably comparable to those of other customers with whom the utility deals at arm's length, many consider that it may be more relevant to recognize the new asset inflows as revenue and an operating flow rather than as a financing inflow.
- 4.44 Similarly, an entity may transfer benefits to a residual interest/equity participant in exchange for supplying goods and services during the period. It may also be more relevant to report this transaction as an expense.
- 4.45 The issue is more complex for non-exchange transactions and for exchange transactions where the consideration paid or received by the reporting entity does not reflect the value of what was exchanged. If the entity's purpose is to provide public sector goods and services and the entity is not assessed on its return on investment, then it may be very difficult to distinguish contributions intended to support increased capacity from those that support current and future period operations. In such cases, whether an item is revenue or a direct increase in the residual interest may only be evaluated, in practice, on the stated intent of the residual interest/equity participant or on existing relationships between the entities rather than on conceptual grounds.
- 4.46 Those who support the position that no transactions with residual interests/equity participants should be excluded from revenues and expenses contend that, in the absence of a conceptual basis for distinguishing between financing and operating flows, all should be reported as revenues and expenses. Supporters also contend that without a need to assess return on investment, the importance of differentiating between the two forms is not an issue. All such transfers should be reported on the statement of financial performance, and affect the surplus/deficit and the residual interest in net assets in this way. They contend that the resulting financial statements are more transparent, relevant, comparable from period to period, and understandable.

### **Result of Specific Activities**

- 4.47 A number of standards-setters limit their definitions of revenue and expense by restricting them to specific types of activities. Revenues and expenses may arise, for example:
- (a) From ordinary revenue-generating or service delivery, activities.<sup>4</sup>
  - (b) From providing and paying for goods or services, receiving donations, or any other activity performed (excluding borrowing and its repayment).

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<sup>4</sup> The IASB has a broad definition of "income," but makes a reference to "ordinary activity" in its narrower definition of revenue.

- (c) From delivering or producing goods, rendering services, or other activities that constitute the entity's major or central operations.
  - (d) From operations, transactions or events.
- 4.48 Such approaches have a common objective of distinguishing transactions and events relating to activities in the normal course of operations from other transactions and events. As such, it differentiates between revenues and expenses, and gains and losses. The latter tend to be identified with changes in net assets from transactions and events peripheral or incidental to the entity's central operations, and which are likely to be interpreted differently from recurring events in any assessment of the future of the entity. Therefore, gains and losses are identified as separate elements, and not as revenues and expenses.
- 4.49 Other standards-setters make clear that the definitions of revenue and expense include gains and losses, as they are considered to be subsets of the primary elements. This is similar, for example, to tangible capital assets and financial assets being considered subsets of assets, and performance obligations and financial obligations being subsets of liabilities. They contend that gains and losses are similar in nature to revenues and expenses as they both are a result of increases and decreases in net benefits. Which items are revenues and expenses or gains or losses, whether they pertain to transactions or to other flows, to operations or to asset and liability management, or to other classifications are issues of financial statement presentation, not one of element identification.
- 4.50 To assist in the development of responses to the following questions, common types of public sector revenues and expenses are set out in Appendix D and Appendix E. These appendices use existing standards to classify the elements into different categories. The classification distinctions used in the standards have not been addressed separately in this CP. This reflects the view that distinctions between non-exchange and exchange transactions and events, for example, or the effect of transferor intent do not affect the revenue and expense definitions. Such distinctions are matters for consideration when developing approaches for recognition, measurement, presentation and disclosure.

**Specific Matters for Comment # 12:**

- (a) What is your view on the following questions?
  - (i) Should transactions with residual interest/equity participants be excluded from or be included in revenues and expenses?
  - (ii) Should the definition of revenue and expense be limited to specific types of activities associated with operations, however described?
- (b) Are there any additional characteristics that have not been identified that you believe are essential to the development of definitions of revenues and expenses?
- (c) Are there other unique public sector revenue and expense considerations that should be considered by the IPSASB?

### Other Potential Elements—Overview

Aside from the four fundamental elements discussed in Sections 2, 3 and 4, three other potential items are considered as potential elements. The decision to be made is whether each of the items discussed is required to be separately identified as an element in order to provide all the required building blocks for a public sector entity's general purpose financial statements.

## 5A Other Potential Elements: Net Assets/Net Liabilities

### Identification of Essential Characteristics of Net Assets/Net Liabilities

- 5.1 Reporting the net financial position of a public sector entity provides valuable information to the primary users of the entity's financial statements. Service recipients and resource providers and their respective advisors use information about the net position at the reporting date to help them in assessing the management of the entity's short term financial capacity and its capacity to sustain the level of programs and services it provides on a longer term basis. Users, therefore, use this information to assess the related aspects of the financial capability and operating capability of the entity.
- 5.2 Standards-setters have established definitions of net assets/net liabilities (or equity), setting out a number of characteristics in those definitions. These characteristics are set out in Appendix F. They suggest a number of issues that need to be resolved in determining what characteristics of net assets/net liabilities are essential to their definition:
- (a) Do net assets/net liabilities simply represent a residual amount?
  - (b) Is there an interest?
  - (c) If there is an interest, is there an ownership interest?
- 5.3 In particular, the issue of whether an "ownership interest" exists in the public sector is important because transactions with owners acting in their capacity as owners can only be distinguished from transactions with owners acting in other capacities, (e.g., as suppliers or customers) if the concept of an ownership interest exists in the public sector.

#### *Is Net Assets/Net Liabilities Simply a Residual Amount?*

- 5.4 The residual amount is the difference between assets and liabilities (or assets and liabilities and deferred outflows and deferred inflows) and results solely from the accumulated revenues and expenses of the past. It represents the net resources available for providing future goods or services, or alternatively, if the balance is negative the future resources necessary to meet claims from the provision of goods or services in the past. If deferred inflows and outflows are recognized as separate elements, in addition to representing the net positive or negative resources available to be carried forward, net assets/net liabilities would also

- include the net deferral of inflows and outflows to be recognized in future operations.
- 5.5 One of the reasons that some standards-setters limit net assets/net liabilities to a residual is that trying to define both liabilities and “equity” items separately can lead to mezzanine items being presented in the statement of financial position that are neither one nor the other. These standards-setters focus on defining a liability and define the residual amount as a calculation dependent upon the result of the difference between assets and liabilities, and deferred flows, if applicable.
- 5.6 To the extent that net assets/net liabilities is defined simply as a residual amount, there may be no need to consider it further as an element of financial statements. It is simply the accumulation of all flows that affect the already-defined elements on the statement of financial position.

*Is There Still an Interest?*

- 5.7 Some argue that the residual could still have economic substance in the form of an interest in the net assets/net liabilities of public sector entities. That interest could be described as an interest in the entity’s operating capability. It exists because the financial expectations of resource providers and service recipients of public sector entities are directly affected by the ability of such entities, at any given time, to carry out their activities at the scale determined by its then-existing resources. Others have described this residual interest as an interest in the capability of the entity to finance itself and resource future operations. Both concepts of residual interest are reflected by net assets/net liabilities and are analogous to, but different from, the ownership interest in a business enterprise.
- 5.8 For example, in the case of agency operations or semi-autonomous entities created by government, financial entitlements to the government may not be provided for, but the government has still provided the capital of the entity, and has the authority to direct the operating and financing activities of the entity in pursuit of the desired public policy objectives of the government. The government has an interest in the residual, more because of the impact on future resource provision and the ability of the entity to provide services, as because of any residual entitlement.
- 5.9 Transfers between levels of government could also usefully be tested against such criteria, thereby allowing both the transferor and transferee to differentiate between capital injections and withdrawals, and revenue and expenses.
- 5.10 A formulation of “residual interest” in the public sector could be the interest of the members/government/community/owner/equity participants in the public sector entity’s operating capability. Alternatively, it could be expressed as their interest in the capability of the entity to finance itself and resource future operations, so far as it reflects the financial expectations of resource providers and service recipients of those entities. For example, the latter description may be appropriate for describing the interest of the government in public sector entities that lack the ability to generate resources through levying taxes or issuing debt, but are financed exclusively by government transfers.

*Is There an Ownership Interest?*

- 5.11 In some jurisdictions, explicit ownership interests may exist in the public sector. For example, at the whole of government level, a government business enterprise (GBE) included in the whole of government entity may have been partially privatized which means that there are third-parties who have a financial interest in the residual amount of that GBE, i.e., an ownership interest. This ownership interest represents the portion of the surplus or deficit for the period and residual amount at the reporting date of a controlled entity attributable to a third-party.
- 5.12 However, generally in the public sector, the net assets of a government do not represent an “ownership” interest in the same sense as a business enterprise. Usually the net assets of a government are a reflection of the resources available to finance or deliver future operations, and, as such, could be interpreted as an ownership interest of the community in general. No explicit outside ownership interest other than this may exist. Because governments often have net liability positions, this may suggest that the concept of an “ownership interest” is redundant.
- 5.13 A government’s net assets are increased (net liabilities decreased) primarily by receipts of assets from resource providers who do not expect to receive either repayment or benefits proportionate to their contributions. Its net assets are decreased (net liabilities increased) primarily by providing goods and services. Therefore it may not be appropriate to represent the residual net assets of governments as an ownership interest.

*Alternative Conceptual Approaches*

- 5.14 A number of alternative conceptual approaches could be adopted. These include:
- (a) Defining “net assets/net liabilities” and treating any specific ownership interest as a sub-classification of net assets;
  - (b) Defining “ownership interest” as a separate element; and
  - (c) Defining one or more components of net assets/net liabilities as elements.
- 5.15 Defining “net assets/net liabilities” and treating any specific ownership interest as a sub-classification reflects an approach that recognises that third parties may have a financial interest in some part of net assets and that separately recognising that financial interest is both necessary and relevant. Accumulated surplus/deficit does not represent an outside claim but rather net resources at the disposal of the government. This approach allows “items” other than that to be presented in the net assets/net liabilities section of the statement of financial position. For example, items such as capital maintenance adjustments and fair value changes would be treated as sub-classifications of net assets/net liabilities and would not need separate element definitions. While it may be necessary to define these items, it is not necessary to define them as elements.
- 5.16 Defining ownership interest as a separate element characterises net assets/net liabilities as a residual amount that can be used both for financing future operations and ownership interests. This approach acknowledges that ownership

- does exist in the public sector, both at the whole of government, but more clearly at the entity level. An ownership interest, such as specified minority interests, can exist separately from the residual amount. From this perspective, ownership interest could be defined as an element because that ownership is an “outside” claim that does not share the same common characteristics of a liability.
- 5.17 Typically the components of the net assets/net liabilities section of the statement of financial position could include but may not be limited to:
- (a) Contributions from owners
  - (b) Distributions to owners
  - (c) Capital maintenance adjustments
  - (d) Fair value changes
  - (e) Operating results
- 5.18 A further approach could be to define each of these components as a separate element. It might be argued that each component shares common characteristics and warrants being identified separately.

**Specific Matters for Comment # 13:**

- (a) Do you consider net assets/net liabilities to be a residual amount, a residual interest, or an ownership interest?
- (b) Should the concept of ownership interests, such as those that relate to minority or non-controlling positions in a GBE, be incorporated in the element definition?
- (c) Are there other relevant issues, and particularly the unique public sector considerations, that the IPSASB needs to consider in determining the concept of net assets/net liabilities?

**5B Other Potential Elements: Transactions with Residual/Equity Interests**

- 5.19 Pending the outcome of the debate on issues associated with residual and equity interests, this section of the CP uses the term “transactions with residual or equity participants” in place of the more common description “contributions/distributions from owners”.

**Essential Characteristics of Transactions with Residual/Equity Participants**

- 5.20 A few standards-setters have established definitions of transactions with residual/equity participants, setting out a number of characteristics in those definitions. These are set out in Appendix F. Others have not defined contributions and distributions related to these interests.
- 5.21 Some public sector standards-setters do not have a definition for transactions with equity participants because they consider ownership interests to be rare, and some

- private sector standards-setters do not have a definition of contributions to and from owners despite having definitions for equity instrument and equity interests.
- 5.22 If the view is taken that net assets/net liabilities is a residual amount and does not represent an interest, then it would be inappropriate to separately identify and represent the existence of transactions that impact on that residual. If, however, it is accepted that a residual or equity interest exists, and there are transactions that directly affect that interest and not financial performance, this may necessitate the identification of other elements.
- 5.23 Those who separately define transactions with residual/equity participants tend to identify common characteristics:
- (a) The contribution or distribution is from or to a party external to the entity.
  - (b) The contribution or distribution establishes or reduces a financial interest in the net assets of the entity.
  - (c) A contribution conveys entitlement to distributions of future benefits or service potential and to distributions of any excess of assets over liabilities in the event of the entity being wound up.
  - (d) The interest can be sold, exchanged, transferred or redeemed.
- 5.24 The first two characteristics have been referred to by one standards-setter as “...increases in residual interest resulting from transfers from parties that establish a financial interest in that residual interest.”<sup>5</sup> It further explains that the “financial interest in the residual interest” is an interest that conveys a right to participate in the residual interest, either on an ongoing basis or in a winding-up, and therefore also incorporates characteristic (c) as well. The definition of contributions from owners for for-profit entities includes the same characteristics. However, the terminology differs to take into account the differences between for-profit entities and public sector entities.
- 5.25 The fourth characteristic above is not unique to residual/equity interests as it can also apply to other elements such as liabilities. This suggests that it is not an essential characteristic to the definition of contributions from owners. The actual definitions, however, indicate that this characteristic refers to the associated financial interest and that it relates only to non-liability financial interests.
- 5.26 It was suggested in the section on net assets/net liabilities that a residual interest in the public sector represents an interest in the entity’s operating capability. Such an interest is unlikely to be able to be sold, exchanged, transferred or redeemed. This type of interest may lead to entitlements in the event of an entity being wound up, although this may not be explicitly stated.
- 5.27 Not all standards-setters’ definitions of distributions mirror their definition of contributions. Some describe a distribution from the viewpoint of the entity, i.e., as being a decrease in residual interest or equity. Other standards-setters describe

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<sup>5</sup> UK ASB for Public Benefit Entities.

- what is distributed: i.e., future economic benefits or service potential, either as a return on investment or as a return of investment.
- 5.28 As discussed in the section on net assets/net liabilities, an ownership interest as commonly understood in the private sector may not exist in many public sector entities. In some cases however, such an ownership interest may arise. For example there may be public sector entities where a private sector entity has a minority interest.
- 5.29 It may be possible to fairly reflect such items without creating the need for a separate element. One approach could be to include this as a component of the residual or residual interest amount and describe it as “minority” or “non-controlling” interest. This refers to the portion of the net assets of the consolidated entity representing the ownership interest attributable to a third-party. The advantage of this method is that all of the assets and liabilities of the consolidated investment controlled by the entity are included in the financial statements.

**Specific Matters for Comment # 14:**

- (a) Should transactions with residual/equity participants be defined as separate elements?
- (b) If defined as separate elements, should such transactions refer to interests that are able to be sold, exchanged, transferred or redeemed (excluding liability interests); that provide entitlement to distributions during the entity’s life and in the event of being wound up; and/or that provide an equity or residual interest represented by a public interest in the operating capability or the capability of the entity at the reporting date to finance itself and resource future operations?

**5C Other Potential Elements: Deferred Outflows and Deferred Inflows**

**Deferred Outflows and Deferred Inflows**

- 5.30 Earlier sections of this paper indicate that some support a measure of financial performance that reports on the extent to which the burden of the current year cost of providing programs and services is borne by current year taxpayers and revenue providers. Under this approach the concept of inter-period equity is considered to be a relevant metric for assessing accountability and providing decision useful information by presenting relevant information as to whether the government has passed on costs or resources to future periods.
- 5.31 This approach defines the elements of revenue and expense on the basis of this inherent characteristic; that is, on their applicability to the current period. This is consistent with the revenue and expense-led approach to elements and financial performance explained in Section 4. Both the concept of inter-period equity and the traditional private sector matching concept associate accounting events with

- periods; however, the criteria for associating events with periods and the objectives of the related financial reporting are different.
- 5.32 The private sector concept attributes costs to the revenues recognized during a period for the purpose of measuring earnings. In contrast, inter-period equity attributes costs of the services to the period in which those services are provided and attributes revenues provided by taxpayers and other revenue providers to the appropriate period for the purpose of assessing whether those revenues were sufficient to finance the costs of providing services during that period.
- 5.33 For example, assume a government imposes (levies) a property tax at the end of the current reporting period that is legally restricted for use in the next reporting period, and the tax does not have a return feature. Those that support the inter-period equity approach do not believe that the recognition of revenue related to this tax levy in the current period is a faithful representation of the results of the current reporting period. In the absence of a performance obligation with a definition broad enough to capture such a transaction as a liability at the end of the current year, there is a need to recognize a deferral element on the statement of financial position.
- 5.34 Supporters of the inter-period equity view suggest that all four major elements (assets, liabilities, revenues and expenses) can be defined according to their inherent characteristics if the deferred outflows and inflows are identified either as *separate* elements or *incorporated into* other elements.

*Alternatives*

- 5.35 If revenues and expenses are to be defined with a characteristic that indicates they are “applicable to” the reporting period as explained in Section 4, and the financial position and financial performance statements are to articulate, then one of the following approaches is required:
- (a) Define deferred outflows and deferred inflows as separate elements on the statement of financial position, or
  - (b) Broaden the definitions of asset and liability elements to encompass items that are deferrals, or
  - (c) Describe the deferred outflows and deferred inflows as sub-classifications of net assets/net liabilities.
- 5.36 Each of the alternatives has its advantages and disadvantages. Recognizing the deferrals as separate elements allows the asset and liability element definitions to continue to represent what assets and liabilities are understood to be in the private sector. This is beneficial for something as basic to financial reporting as assets and liabilities and increases the understandability of public sector financial statements.
- 5.37 The first approach maintains a flow of resources approach and defines deferred items as follows:
- Deferred outflow (of resources): an entity’s consumption or reduction of net assets that is applicable to a future reporting period

- Deferred inflow (of resources): an entity's increase or acquisition of net assets that is applicable to a future reporting period

The term "net assets" (assets less liabilities) is used in these definitions to differentiate these items from the results of transactions and events such as the repayment of debt or the acquisition of property, plant and equipment with a cash payment, where there is no change in the net asset amount. The timing of recognition of a deferred outflow or deferred inflow is addressed in the discussion on recognition.

- 5.38 The first approach also articulates the elements on the statement of financial position with the statement reporting on financial performance. That is, the net financial position at the first of the period (assets + deferred outflows – liabilities – deferred inflows) plus revenues less expenses for the period equals the net financial position at the end of the period.
- 5.39 Incorporating deferred outflows and deferred inflows into the definitions of the asset and liability elements, respectively, reduces the number of key elements making up financial statements, making it easier to understand how the major financial statements articulate with each other. However, faithful representation would not be met by including such items as deferred exchange losses, for example, as entity assets.
- 5.40 If deferred outflows and deferred inflows are reported instead as sub-classifications of the net financial position, no new elements need to be added and assets and liabilities continue to be defined in terms of resources and obligations. On the other hand, transparency is reduced as the results of major flows in the period are relegated to a sub-category of residual interest or "equity" represented by net assets/net liabilities. Again, the articulation of the statements representing financial position and financial performance is not so clearly evident, nor are the deferrals themselves.

**Specific Matters for Comment #15:**

- (a) Do deferrals need to be identified on the statement of financial position in some way?
- (b) If yes, which approach do you consider the most appropriate? Deferred outflows and deferred inflows are:
- (i) Defined as separate elements
  - (ii) Included as sub-components of assets and liabilities
  - (iii) Included as sub-components of net assets/net liabilities
- (c) If defined as separate elements, are the definitions of a deferred outflow and deferred inflow as set out in 5.37 above appropriate and complete?

## 6 Recognition

### Overview

Section 6 discusses issues related to element recognition: why recognition criteria are needed, how uncertainty affects recognition, whether the criteria apply equally to the derecognition of elements, and whether the criteria should be separate requirements or an integral part of the element definitions. The section concludes with a discussion of the relationships between recognition and qualitative characteristics, and recognition and disclosure.

### Introduction: The Need for Recognition Criteria

- 6.1 Recognition is the process of incorporating an item that meets the definition of an element and can be measured reliably in the relevant financial statement. Recognition involves the depiction of the item in words and by a monetary amount and the inclusion of the item's value (that amount), in aggregates or, on rare occasions, as a discrete line item on the face of a financial statement. An item must meet both the definition of a particular element and the recognition criteria in order to be recognized.
- 6.2 Recognition also includes timing considerations: it involves recording an element at the time of an initial transaction or event, or subsequently when the required recognition criteria have been met. Recognition also entails an evaluation of whether changes have occurred that warrant removing a previously recognized item from the financial statements. The latter process is derecognition.

### Uncertainty

- 6.3 Accrual accounting recognizes transactions and events when those transactions and events occur rather than when they are realized or settled. Uncertainty is therefore inherent and unavoidable in the accrual basis of accounting. Two areas of uncertainty are addressed in this section:
- (a) Uncertainty about whether assets, liabilities, revenue and expenses meet element definitions (existence uncertainty);
  - (b) Uncertainty about the reliability of the amount associated with those elements (measurement uncertainty).

#### *Existence Uncertainty*

- 6.4 It is often clear whether the definition of an element has been satisfied. Although the occurrence of a transaction may not be necessary in order for an element to exist, transactions are the most common basis for recognizing and derecognizing items as elements. For example, the rendering of services by an employee in accordance with a contract of employment gives rise to a liability and an expense of the employer, the acquisition of medical equipment normally provides sufficient information to justify the recognition of an asset, and the destruction of a building in a natural disaster leads to the derecognition of that asset.

- 6.5 In other cases, it is more difficult to determine whether a transaction or event creates an item that meets the definition of an element. Entities operate in uncertain environments. Evaluating whether an item meets the definition of an asset may require an assessment of an entity's legal position at the reporting date to determine whether there is a present entitlement to future benefits. Existence uncertainty demonstrates the tension between fair representation and relevance.
- 6.6 Uncertainty can be countered by assessing the available evidence. The more evidence there is about an item and the better the quality of that evidence, the less uncertainty there will be whether an item meets the definition of an element. Recognition criteria therefore should require preparers to review and assess all available evidence in determining whether sufficient evidence exists that an asset or liability should be recognized initially, whether it continues to qualify for recognition, or whether there has been an addition to an existing asset or liability.
- 6.7 Many standards-setters address existence uncertainty by requiring evidence thresholds as recognition criteria. For example, an item is recognized only if it is "probable" or "more likely than not" that future economic benefits associated with the item will flow to or from the entity.
- 6.8 Standards-setters have commonly set differential thresholds. For example, while the threshold for liabilities may be "probable" or "more likely than not," the criterion for recognition of some assets (e.g., a contingent asset) may require a higher standard of evidence—perhaps "virtual certainty." Other assets, such as property, plant and equipment, may be recognized when the future benefits are "probable."
- 6.9 In the past, the main rationale for the use of differential threshold criteria has been prudence: a higher level of evidence is required for an item where previous uncertainty over its existence indicates that its recognition has not been justified. However, requiring that a particular item is recognized as an asset only if its realization is "virtually certain" while liabilities and other assets are recognized when an outflow or inflow of resources is "probable" introduces bias into financial statements. Such bias may be contrary to the qualitative characteristic of faithful representation. In accordance with its views in the first Conceptual Framework Consultation Paper, the IPSASB does not consider that prudence should be a factor in determining threshold criteria.
- 6.10 Some standards-setters have become wary of using evidence thresholds at all and now try to avoid bright lines or binary demarcation points. Instead they rely on a more general assessment of available evidence to resolve element uncertainty. In accordance with this approach some private sector standards (e.g., IFRS) are being changed to require a firm judgment to be made about the element's existence. Evidence thresholds are removed from the definition and recognition criteria, and are incorporated instead in measurement considerations.
- 6.11 There are three approaches to dealing with existence uncertainty:
- (a) Standardize threshold criteria

- (b) Use all available evidence to make neutral judgments about the element's existence
  - (c) Use threshold criteria or neutral judgments, depending on the underlying measurement basis of the element
- 6.12 The main advantage of the *first approach* which uses and standardizes evidence threshold criteria for all elements is that such criteria are understandable and act as filters, screening out items that have a low probability of resulting in inflows or outflows of benefits. They therefore contribute to understandability by not presenting items that have a low or even remote likelihood of occurrence in the GPFS. Such items may have high monetary values and therefore lead to the recognition of assets and liabilities with significant carrying values, even though the probability of existence may be very low. Some consider that it would be more appropriate to disclose such items rather than recognize them.
- 6.13 Threshold criteria can also be justified on cost grounds. Only after a preparer has formed an initial judgment whether the threshold criterion has been met does that preparer proceed to consider how that element should be measured. Measurement can be an expensive process, particularly where there is a significant level of measurement uncertainty, and the benefit of information to users may not be commensurate with the cost for items which have only a small possibility of occurring.
- 6.14 The *second approach* requires an entity to make a neutral judgment about whether an element exists. This is based on its understanding of all available facts and circumstances at the reporting date. If it is determined that an element exists, uncertainty about the flows associated with that element is taken into account in measurement. The major argument in favour of this approach is that it provides better information because the elements recognized better meet the qualitative characteristics of faithful representation, relevance and comparability. Supporters contend that the evidence threshold approach disregards items that are below such thresholds, perhaps by very small margins, but which, in all other ways, meet the definition of an element.
- 6.15 It has been suggested that the phrase “expected to flow” used in many current frameworks and element definitions has been misinterpreted to mean that there must be a high expectation of an inflow or outflow of future benefits to justify recognition. Items with a lower likelihood are not recognized. To avoid this common misinterpretation, either the element definitions could exclude reference to the “expected” inflow or outflow of benefits, or the discussion of each element could explain that this characteristic should be interpreted to mean that there must be some expectation of future inflows or outflows, and that the phrase does not imply that a particular threshold level needs to be met.
- 6.16 The *third approach* to dealing with existence uncertainty is situational. Because recognition criteria apply equally well to both initial and subsequent recognition, different requirements could apply to an element depending on its measurement basis. After an element has been recognized initially, it must pass recognition tests again at each reporting date in order to continue being reported.

- 6.17 In accordance with this view if the measurement basis of an element incorporates a current assessment at each reporting date of the probability of the inflows or outflows of benefits, an evidence threshold should not be included as a recognition criterion. This may happen, for example, when measurement is based on a current market value.
- 6.18 Conversely, if the measurement attribute applied to an element does not incorporate a current assessment of the probability of the inflows or outflows of benefits at the reporting date, an evidence threshold should be required. Examples of such measurement attributes are historical cost and market values determined by reference to depreciated replacement cost.
- 6.19 It could be argued, however, that even elements measured at historical cost are reviewed regularly for impairment on the basis of a current assessment of the probability of inflows or outflows of benefits. Therefore, a threshold test for continued recognition of an element measured on a basis such as historical cost may not be required. This argument is perhaps less forceful in the public sector where non-financial assets do not usually generate future benefits in the form of cash flows. Because probabilistic measures of future service potential are more difficult to measure, threshold criteria may be easier to apply.

*Measurement Uncertainty*

- 6.20 Measurement uncertainty may arise even though existence uncertainty has been overcome. An item may meet the definition of an element, but it cannot be measured in monetary terms or a reasonable estimate of the amount cannot be made.
- 6.21 To recognize an item in the financial statements, it is necessary to attach a monetary value to the item. This entails two different aspects: the first is choosing an appropriate measurement basis (cost, market value, depreciated replacement cost, etc.); and the second is the reliability of the measurement itself. The selection of an appropriate measurement basis is considered in the Conceptual Framework Consultation Paper dealing with measurement.
- 6.22 There is inevitably a degree of uncertainty associated with the measurement of many financial statement amounts. The use of estimates is an essential part of the accrual basis of accounting. A decision about measurement reliability is a matter of professional judgment. Management considers information such as what amounts are reasonably possible, whether additional evidence is available about conditions that existed at the reporting date, the impact of other reasonably possible amounts on the recognized resources, obligations and net assets, and the possible timing of that impact.

**Specific Matters for Comment # 16:**

- (a) Should recognition criteria address evidence uncertainty by including evidence thresholds (such as probable, more likely than not, or virtual certainty of an inflow or outflow of benefits); or by requiring a neutral judgment whether an element exists at the reporting date based on an

assessment of all available evidence; or by basing the approach on the measurement attribute?

- (b) If you support the threshold approach or its use in a situational approach, do you agree that there should be uniform thresholds for both assets and liabilities? If so, what should it be? If not, what threshold is reasonable for asset recognition? For liability recognition?

### **Derecognition**

- 6.23 One aspect of recognition is whether the same principles dealing with existence and measurement uncertainty should apply equally to both initial and subsequent recognition. Some consider that ‘recognition’ refers to initial recognition only, and that an item, once recognized, should only be derecognized once separate and explicit criteria for derecognition are met. Under this view, the explicit criteria for derecognition may, but need not be, the obverse of recognition criteria. For example, some argue that the criteria for derecognizing a liability should be more stringent than the criteria for initially recognizing the liability.
- 6.24 Such an approach does not appear to be in accordance with the qualitative characteristic of fair representation. For the same reasons that the IPSASB does not support differential evidence thresholds at initial recognition the IPSASB does not favour thresholds for derecognition that differ from those for initial recognition.

#### **Specific Matter for Comment # 17:**

Do you support the use of the same recognition criteria for initial and subsequent recognition?

### **Should Definitions Incorporate Recognition Criteria**

- 6.25 At present some standards-setters incorporate recognition criteria in element definitions. The issue of whether definitions should include recognition criteria is a matter of location rather than substance. Those who favour the inclusion of recognition criteria within definitions consider it appropriate for preparers to be able to consider all the factors that must be taken into account in evaluating whether an item is recognized. Others consider that recognition is a distinct stage in the accounting process that takes place only after an item meets an element definition. In this latter view, a clearer distinction is made, resulting in less confusion about what should be captured. Such confusion can be seen in how the current phrase “expected to flow” has led to different interpretations. It therefore may be advisable to keep the stages discrete.

#### **Specific Matter for Comment # 18:**

Do you agree that the Conceptual Framework should identify recognition criteria separately from the element definitions?

### **Recognition Criteria and Qualitative Characteristics**

- 6.26 It is important that the information that results from applying any recognition criteria reflects the qualitative characteristics necessary for financial information to be useful.
- 6.27 General recognition criteria developed by standards-setters usually incorporate aspects of the qualitative characteristics. As indicated in Appendix G, this is principally reflected in a requirement that measurement be reliable and lead to fair representation. Reliability may be implied by requiring that a reasonable estimate can be made of the amount involved or that a monetary amount can be expressed with reasonable certainty or is reasonably estimable.
- 6.28 The information conveyed by recognizing an element or a change in an element in the financial statements must be relevant as well as reliable. Requiring an item to have an “appropriate basis of measurement” conveys notions of both qualities.
- 6.29 As indicated above, there can be tensions between individual qualitative characteristics that require trade-offs to be made in order to resolve issues. For example, fair representation may affect the timing of recognition. The first available information about an event that may have resulted in an element is sometimes too uncertain to justify recognition: it may not yet be clear whether an item meets one or more of the attributes in a definition or whether such an item is measurable. The unavailability or unreliability of information may justify delaying recognition of an item. However, waiting for virtually complete reliability may make recognition so untimely that the information loses its relevance. Therefore judgment needs to be exercised as to when a relevant item becomes measurable with sufficient reliability to meet the qualitative characteristic of fair representation.

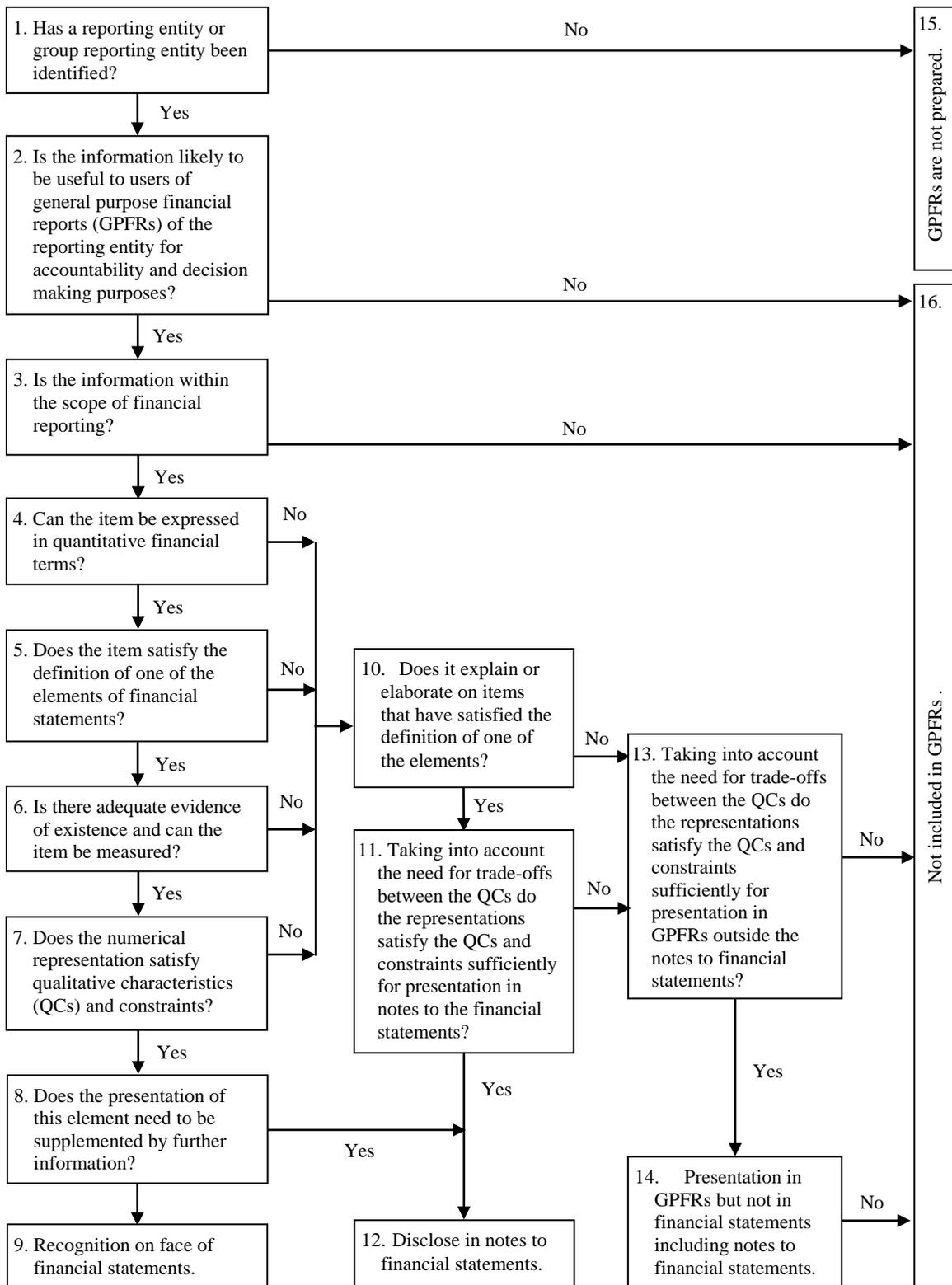
### **Relationship between Recognition and Disclosure**

- 6.30 There is general acceptance that the disclosure of accounting policies used and information in notes to the financial statements do not compensate for the failure to recognize items that meet definitions and specified recognition criteria. Such items should be recognized in the financial statements.
- 6.31 While disclosure in the notes is not a substitute for recognition, disclosure in the notes about how uncertainty has been approached can enhance information needed for the evaluation of accountability and for decision making. Disclosure can provide information about the estimation methodologies used; for example about whether an estimate was based on observation of an active market price or involved other techniques such as mathematical modelling due to the absence of an observable market. Disclosure can also indicate the range of estimates that has been identified.
- 6.32** Notes to the financial statements provide further details about items recognized in the financial statements. Disclosures on liabilities, for example, can provide information on maximum risk exposures and the sensitivity of results to particular risks. Notes can also provide information about items that are not recognized in

the accounts, but that meet some but not all the required attributes in a definition or recognition criteria.

Appendix A

**A1 Reporting Information in Accordance with the Conceptual Framework**



**Appendix B**

**B1 Existing Characteristics of Assets Identified by Current Standards-setters**

In the following table, an “X” means the characteristic is part of the definition and a “G” means that it is provided as additional guidance supporting the definition.

Source	Resource	Past transaction or event	Expected inflow of economic benefit or service potential	Rights or other access	Controlled by the entity
IPSASB	X	X	X		X
PSAB	X	X	X		X
SA ASB	X	X	X		X
FASAB	X	G	X		X
GASB	X	G	X		X
IASB	X	X	X		X
Can AcSB	X	X	X		X
UK ASB		X	X	X	
UK ASB PBE		X	X	X	
US FASB		X	X		X
AASB	X	X	X		X
NZ FRSB	X	X	X		X
GFS	X	X	X		

**B2 Existing Definitions of Assets of Standard Setting Bodies**

Public Sector Accounting Standards-setters	
Canada PSAB	Assets are economic resources controlled by a government as a result of past transactions or events and from which future economic benefits are expected to be obtained.
South Africa ASB	An asset is a resource controlled by the entity as a result of past events and from which future economic benefits or service potential is expected to flow to the entity.
US FASAB	An asset is a resource that embodies economic benefits or services that the federal government can control.
US GASB	Assets are resources with present service capacity that the government presently controls.
Private Sector Accounting Standards-setters	
IASB	An asset is a resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity.
Canada AcSB	Assets are economic resources controlled by an entity as a result of past transactions or events and from which future economic benefits may be obtained.
UK ASB	Assets are rights or other access to future economic benefits controlled by an entity as a result of past transactions or events.
UK ASB – PBE	Assets are rights or other access to future economic benefits controlled by an entity as a result of past transactions or events.
US FASB	Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.
Accounting Standards-setters for Both Private and Public Sectors	
Australia ASB	An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
NZ FRSB	An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.
Other	
Government Finance Statistics	Assets are assets over which general government units enforce ownership rights and from which they may derive economic benefits beholding or using them over a period of time.

Appendix C

**C1 Existing Characteristics of Liabilities Identified by Current Standards-setters**

In the following table, an “X” means the characteristic is part of the definition and a “G” means that it is provided in additional guidance supporting the definition.

Source	Present obligation	Expected outflow or transfer of economic benefit or service potential	Past event	No realistic alternative	Little or no discretion to avoid	To others or from the entity	Specified or determinable date, on occurrence of a specified event, or on demand
IPSASB	X	X	X	G		X	
PSAB	X	X	X	G	G	X	G
SA ASB	X	X	X			X	
FASAB	X	X	G			X	X
GASB	X	X	G		X	G	
IASB	X	X	X			X	
Can AcSB	X	X	X	G	G	G	G
UK ASB	X	X	X	G		G	
UK ASB PBE	X	X	X	G		G	
US FASB	X	X	X		G	X	G
AASB	X	X	X			X	
NZ FRSB	X	X	X			X	
GFS	X	X	G			G	

## C2 Existing Definitions of Liabilities of Standard Setting Bodies

Public Sector Accounting Standards-setters	
IPSASB	<b>Liabilities</b> are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.
Canada PSAB	<b>Liabilities</b> are present obligations of a government to others arising from past transactions or events, the settlement of which is expected to result in the future sacrifice of economic benefits.
South Africa ASB	A <b>liability</b> is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.
US FASAB	A <b>liability</b> is a present obligation of the federal government to provide assets or services to another entity at a determinable date, when a specified event occurs, or on demand
US GASB	<b>Liabilities</b> are present obligations to sacrifice resources that the government has little or no discretion to avoid.
Private Sector Accounting Standards-setters	
IASB	A <b>liability</b> is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
Canada AcSB	<b>Liabilities</b> are obligations of an entity arising from past transactions or events, the settlement of which may result in the transfer or use of assets, provision of services or other yielding of economic benefits in the future.
UK ASB	<b>Liabilities</b> are obligations of an entity to transfer economic benefits as a result of past transactions or events.
UK ASB – PBE	<b>Liabilities</b> are obligations of an entity to transfer economic benefits as a result of past transactions or events.
US FASB	<b>Liabilities</b> are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.
Accounting Standards-setters for Private and Public Sectors	
Australia ASB	A <b>liability</b> is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
NZ FRSB	A <b>liability</b> is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
Other	
GFS	<b>Liabilities</b> are obligations to provide economic benefits to the units holding the corresponding claims.

**Appendix D**

**D1 Characteristics of Revenue Identified by Current Standards-setters**

Standards-setters have established definitions of revenue, setting out a number of characteristics in those definitions. In the following table, an “X” means the characteristic is part of the definition.

Source	Increase (of economic resources)	Gross Inflow (of economic resources)	Inflows include enhancements	Exclude contributions from owners	Result from activity	During reporting period	Applicable to reporting period
IPSASB		X		X		X	
Can PSAB	X				X	X	
SA ASB		X		X		X	
FASAB	X				X	X	
GASB		X					X
IASB (income)	X		X	X		X	
Can AcSB	X		X		X		
UK ASB PBE	X			X			
US FASB		X	X		X		
AASB	X	X	X	X		X	
NZ FRSB		X	X	X		X	

*Common types of revenue in the public sector*

Exchange transactions IPSAS 9)	Non-exchange transactions (IPSAS 23)	Other events excluding price changes	Price changes
<ul style="list-style-type: none"> <li>The rendering of services;</li> <li>The sale of goods;</li> <li>The use by others of entity assets yielding interest, royalties and dividends.</li> </ul>	<ul style="list-style-type: none"> <li>Taxes, including income tax, value added tax, goods and services tax, customs duty, death duties, and property tax;</li> <li>Transfers, including grants, debt forgiveness, fines bequests, gifts, donations, and goods and services in-kind.</li> </ul>	<ul style="list-style-type: none"> <li>Reversals of asset impairment (IPSAS 17);</li> <li>Changes in policy relating to items such as employee future benefits or social policy benefits (IPSAS 25);</li> <li>Changes in accounting estimates (IPSAS 3).</li> </ul>	<ul style="list-style-type: none"> <li>Revaluations of financial assets such as investments (IPSAS 29);</li> <li>Revaluations of liabilities such as foreign currency translation (IPSAS 4);</li> <li>Revaluations of non-financial assets such as property, plant and equipment (IPSAS 17).</li> </ul>

**Appendix E**

**E1 Characteristics of Expenses Identified by Current Standards-setters**

Standards-setters have established definitions of expense, setting out a number of characteristics in those definitions. In the following table, an “X” means the characteristic is part of the definition.

Source	Decrease (of economic resources)	Gross Outflow (of economic resources)	Outflows include depletions or consumption of resources	Exclude distributions from owners	Result from activity	During reporting period	Applicable to reporting period
IPSASB	X		X	X		X	
Can PSAB	X				X	X	
SA ASB	X		X	X		X	
FASAB	X				X	X	
GASB		X					X
IASB	X		X	X		X	
Can AcSB	X		X		X		
UK ASB PBE	X			X			
US FASB		X	X		X		
AASB	X	X	X	X		X	
NZ FRFB		X	X	X		X	

*Common types of expense in the public sector*

Exchange transactions	Non-exchange transactions	Other events excluding price changes	Price changes
<ul style="list-style-type: none"> <li>The acquisition of services;</li> <li>The purchase of goods;</li> <li>Salaries, wages and benefits;</li> <li>The use by the entity of others assets incurring interest, royalties and dividends.</li> </ul>	<ul style="list-style-type: none"> <li>Social policy obligations such as health welfare and education;</li> <li>Military and other protection to persons and property;</li> <li>Transfer payments, including grants, debt forgiveness, fines bequests, gifts, donations, and goods and services in-kind.</li> </ul>	<ul style="list-style-type: none"> <li>Asset impairment and write-downs (IPSAS 17);</li> <li>Changes in policy relating to items such as employee future benefits of social policy benefits (IPSAS 25);</li> <li>Changes in accounting estimates (IPSAS 3).</li> </ul>	<ul style="list-style-type: none"> <li>Revaluations of financial assets such as investments;</li> <li>Revaluations of liabilities such as foreign currency translation (IPSAS 4);</li> <li>Revaluations of non-financial assets such as property, plant and equipment (IPSAS 17).</li> </ul>

**Appendix F**

**F1 Characteristics of Net Assets/Equity Identified by Current Standards-setters**

Standards-setters have established definitions of net assets/equity, setting out a number of characteristics in those definitions. In the following table, an “X” means the characteristic is part of the definition.

Source	Arithmetic difference between assets and liabilities	Residual Amount	Residual Interest	Ownership Interest
IPSASB			X	
SA ASB	X		X	
FASAB	X			
GASB		X		
IASB	X		X	
Can AcSB	X			X
UK ASB PBE	X	X		X
US FASB	X		X	
AASB	X		X	
NZ FRSB	X		X	
German ASB		X		X
Japan ASB	X		X	

*Characteristics of Transactions with Equity Participants*

Standards-setters have established definitions of transactions with equity participants. In the following table, an “X” means the characteristic is part of the definition and a “G” means that it is provided in additional guidance supporting the definition.

Source	Future economic benefits or service potential that has been contributed to the entity	By parties external to the entity	Excludes items that result in liabilities of the entity	Establishes a financial interest in the net assets/equity of the entity	Conveys entitlement to distributions during life and in the event of being wound up	Can be sold, exchanged, transferred or redeemed
IPSASB	X	X	X	X	X	X
SA ASB	X	X	X	X	X	X
NZ FRSB	X	X	X	X	X	X
UK ASB PBE	X	X	X	X	G	

Appendix G

G1 Recognition Criteria Identified by Accounting Standards-setters

Public Sector Accounting Standards-setters	
Canada PSAB	The recognition criteria are as follows: (a) the item has an appropriate basis of measurement, and a reasonable estimate can be made of the amount involved; and (b) for an item that involves obtaining or giving up future economic benefits, it is expected that such benefits will be obtained or given up.
South Africa ASB	The recognition criteria are as follows: (a) the item has an appropriate basis of measurement, and a reasonable estimate can be made of the amount involved; and (b) for an item that involves obtaining or giving up future economic benefits, it is expected that such benefits will be obtained or given up.
US FASAB	The basic recognition criteria established in this Statement are (a) the item meets the definition of an element of financial statements and (b) the item is <b>measurable</b> . As used in this Statement, the term <i>measurable</i> means that a monetary amount can be determined with reasonable certainty or is reasonably estimable.
Private Sector Accounting Standards-setters	
IASB	An item that meets the definition of an element should be recognized if: (a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and (b) the item has a cost or value that can be measured with reliability.
Canada AcSB	The recognition criteria are as follows: (a) the item has an appropriate basis of measurement and a reasonable estimate can be made of the amount involved; and (b) for items involving obtaining or giving up future economic benefits, it is probable that such benefits will be obtained or given up.
UK ASB: No different requirements for PBEs	If a transaction or other event has created a new asset or liability or added to an existing asset or liability, that effect will be recognized if: (a) sufficient evidence exists that the new asset or liability has been created or that there has been an addition to an existing asset or liability; and (b) the new asset or liability or the addition to the existing asset or liability can be measured at a monetary amount with sufficient reliability.
US FASB	An item and information about it should meet four fundamental recognition criteria to be recognized and should be recognized when the criteria are met, subject to a cost-benefit constraint and a materiality threshold. Those criteria are: <i>Definitions</i> —The item meets the definition of an element of financial statements. <i>Measurability</i> —It has a relevant attribute measurable with sufficient reliability. <i>Relevance</i> —The information about it is capable of making a difference in user decisions. <i>Reliability</i> —The information is representationally faithful, verifiable, and neutral.

<b>Accounting Standards-setters for Private and Public Sectors</b>	
Australia AASB	<p>An item that meets the definition of an element should be recognized if:</p> <ul style="list-style-type: none"><li>(a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and</li><li>(b) the item has a cost or value that can be measured with reliability.</li></ul>
NZ FRSB	<p>An asset shall be recognised in the statement of financial position when and only when:</p> <ul style="list-style-type: none"><li>(a) it is probable that the service potential or future economic benefits embodied in the asset will eventuate; and</li><li>(b) the asset possesses a cost or other value that can be measured with reliability.</li></ul> <p>A liability shall be recognised in the statement of financial position when and only when:</p> <ul style="list-style-type: none"><li>(a) it is probable that the future sacrifice of service potential or future economic benefits will be required; and</li><li>(b) the amount of the liability can be measured with reliability.</li></ul> <p>Revenues shall be recognised in the determination of the result for the reporting period, when and only when:</p> <ul style="list-style-type: none"><li>(a) it is probable that the inflow or other enhancement or saving in outflows of service potential or future economic benefits has occurred; and</li><li>(b) the inflow or other enhancement or saving in outflows of service potential or future economic benefits can be measured with reliability.</li></ul> <p>Expenses shall be recognised in the determination of the result for the reporting period, when and only when:</p> <ul style="list-style-type: none"><li>(a) it is probable that the consumption or loss of service potential or future economic benefits resulting in a reduction in assets and/or an increase in liabilities has occurred; and</li><li>(b) the consumption or loss of service potential or future economic benefits can be measured with reliability.</li></ul>

## **PREFACE**

The IPSASB is undertaking a major project to develop a Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities. The objective of this project is to develop concepts, definitions, and principles that are appropriate to guide the development of IPSASs and other documents dealing with financial reporting by public sector entities.

Many of the current IPSASs are based on International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB), to the extent that the requirements of those IFRSs are relevant to the public sector. While the IASB is currently developing an improved conceptual framework for private sector business entities that is being closely monitored by the IPSASB, IPSASB's conceptual framework project is not an IFRS convergence project aimed at interpreting the IASB framework to the public sector. The IPSASB's project is to develop its own conceptual framework appropriate to the needs of the public sector and those who use its financial reports. IPSASB will consider the concepts underlying statistical financial reporting models and the potential for convergence with them, where appropriate, in developing its conceptual framework.

Although the components of the conceptual framework are interconnected, the project is being developed in phases. In September 2008, IPSASB published the first consultation paper in the project on the objectives, scope and qualitative characteristics of financial reporting and the reporting entity. The IPSASB has considered comments on this paper and approved an exposure draft on this phase in November 2010. Following the consultation paper on elements and recognition, separate consultation papers are planned for Phase 3 on measurement and Phase 4 on presentation and disclosure.

With the Phase 2 Consultation Paper on Elements and Recognition, the IPSASB seeks feedback to guide the IPSASB in developing the concepts underlying the elements of general purpose financial statements and their recognition. The IPSASB will consider carefully all feedback and discuss the responses to the proposals in public meetings. The IPSASB plans to issue an exposure draft setting out its views in late 2011.

## **EXECUTIVE SUMMARY**

The IPSASB has made a number of tentative decisions regarding the objectives and scope of financial reporting that will be important in making further decisions about the elements of financial statements. It has concluded that general purpose financial reports (GPFRs) are financial reports intended to meet the common information needs of users who are unable to command the preparation of financial reports tailored to meet their needs, and expects that the scope of financial reporting will evolve over time in response to users' information needs. Further, GPFRs of public sector entities are broader than financial statements and their notes as currently dealt with in IPSASs. However, financial statements and their notes remain at the core of financial reporting.

This Consultation Paper (CP) discusses issues associated with the elements of general purpose financial statements of public sector entities and their recognition. Elements are the basic building blocks of financial statements needed to meet the information needs of the identified users of these financial reports. This paper considers both how these elements might be defined and what criteria might be established for their recognition.

The CP begins by identifying issues associated with assets and liabilities: what makes up the substance of each, how to determine if it is the entity's asset or liability, and how to determine if the element exists at the reporting date. The CP suggests several characteristics and looks for input on which ones might be critical to the element definitions.

The paper then discusses how IPSASB might approach reporting public sector financial performance, an issue that affects not only the revenue and expense elements, but also whether additional financial position elements (deferrals) are necessary. Two underlying conceptual views of financial performance are set out. One measures financial performance as the net result of all changes in the entity's economic resources and obligations during the period (asset and liability-led view), and the other measures financial performance as the result of the revenue inflows and expense outflows more closely associated with the efforts of the current period (revenue and expense-led view).

This discussion leads into issues associated with identifying what revenues and expenses are in the public sector: whether they are based on changes in net assets/liabilities or on an association with the services and programs provided in the period; whether transactions with residual interest/equity participants should be excluded from their definitions; and whether revenue and expenses should be restricted to the results of specific activities.

The CP next identifies other items that might be separately defined as elements in order to provide all the required building blocks for a public sector entity's financial statements. These include net assets/net liabilities, transactions with residual interests, and deferred outflows/deferred inflows. The issues relevant to each are discussed.

The concluding section sets out the issues associated with recognition criteria; that is, those additional requirements that need to be met after an item has met an element's definition.

## **REQUEST FOR COMMENTS**

The Consultation Paper sets out the specific matters on which comments are requested. The IPSASB has not provided tentative views on the issues so as to get the widest possible consultation. Respondents may choose to address all or just selected matters, and are welcome to comment on any other matter they think the IPSASB should consider in forming its views. Comments are most helpful if they indicate the specific matter, paragraph or groups of paragraphs to which they relate, contain a clear rationale and, where applicable, provide suggestions for proposed improvements.

A list of the specific matters for comment requested in the Consultation Paper is provided below.

### **Key Issues in Section 2: Assets**

#### *Specific Matters for Comment #1:*

- (a) What term should be used in the definition of an asset:
  - (i) Economic benefits and service potential, or
  - (ii) Economic benefits
- (b) The substance of an asset is identified as a resource representing three potential types of benefits—those in the form of service potential, those in the form of net future cash flows (or reduced net cash outflows), and those representing unconditional promises and other abilities to require provision of economic resources in the future. Do you support including all three types of benefits as characteristics of an asset?

#### *Specific Matters for Comment #2:*

- (a) Which approach do you believe should be used to associate an asset with a specific entity:
  - (i) Control
  - (ii) Risks and rewards
  - (iii) Access to rights
- (b) Does an entity's legal or other enforceable claim to benefits or ability to deny, restrict or otherwise regulate the access of others link a resource to a specific entity? Is this an essential characteristic of an asset?
- (c) Are there additional requirements necessary to establish a link between the entity and an asset?

#### *Specific Matter for Comment #3:*

Does the existence of an asset depend on the occurrence of a past transaction or event? What other criteria are helpful in determining if a resource is a "present" resource?

*Specific Matter for Comment #4:*

Recognition and measurement criteria aside, are public sector entity rights and powers such as those associated with the power to tax and levy fees inherent assets of a public sector entity, or are they assets only when those powers are exercised?

*Specific Matters for Comment #5:*

- (a) Are there any additional characteristics that have not been identified that you believe are essential to the development of an asset definition?
- (b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of assets?

**Key Issues in Section 3: Liabilities**

*Specific Matters for Comment #6:*

- (a) Do you agree that the substance of a liability includes being an obligation to transfer benefits, defined as cash and other assets and the provision of goods and services, in the future?
- (b) Obligations could also be interpreted to include unconditional promises, including unconditional promises to stand ready to ensure against loss (risk protection); performance obligations; and obligations to provide access to resources or forego resources in the future. Do all of these promises and obligations result in obligations for the purpose of liability definition?
- (c) Is the requirement for a settlement date an essential characteristic of a liability?

*Specific Matters for Comment #7:*

- (a) Should the ability to identify a specific party(ies) outside the reporting entity to whom the entity is obligated be considered an essential characteristic in defining a liability, or be part of the supplementary discussion?
- (b) Do you agree that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability?
- (c) Which of the three approaches discussed do you support in determining whether an entity has or has not a realistic alternative to avoid the obligation?

*Specific Matter for Comment #8:*

Is the occurrence of a past transaction or event an essential characteristic of a liability? What other criteria are helpful in determining if an obligation is “present”?

*Specific Matters for Comment #9:*

- (a) Recognition and measurement criteria aside, are a public sector entity’s obligations such as those associated with its duties and responsibilities as a government, liabilities of the entity?
- (b) Is the enforceability of an obligation through legal or other means an essential characteristic of a liability?

- (c) Do you agree that any discussion of liabilities must include an assumption about the role that sovereign power plays in that definition, such as by reference to the legal position at the reporting date?

**Specific Matters for Comment #10:**

- (a) Are there any additional characteristics that have not been identified that you believe are essential to the development of a liability definition?
- (b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of liabilities?

**Key Issues in Section 4: Financial Performance: Revenues and Expenses**

This section begins by looking at two conceptual approaches to financial performance that affect the definitions of revenue and expense as well as whether additional elements (deferred outflows and deferred inflows) need to be identified. Respondents are asked to take a position on what constitutes financial performance as a basis for answering subsequent questions.

*IPSASB Conceptual View:*

Please consider the following conceptual choice. It will be useful in helping you form the basis for conclusions on some of the elements that remain.

Issue: Should the measure of financial performance be based on a process of allocating inflows and outflows to particular periods (a revenue and expense-led approach) or should financial performance be based on changes in the period in the net resources/obligations of an entity (an asset and liability-led approach)? What arguments do you consider most compelling in coming to your conclusion?

*Specific Matter for Comment #11:*

As indicated above, this fundamental issue determines both how revenues and expenses should be defined and also whether deferred outflows and deferred inflows are necessary elements of general purpose financial statements.

Should revenues and expenses be determined by changes in net assets (including deferrals) that are “applicable to” the current period, or by changes in net assets (defined as resources and obligations) “during” the current period?

*Specific Matters for Comment #12:*

- (a) What is your view on the following questions?
  - (i) Should transactions with residual interest/equity participants be excluded from or be included in revenues and expenses?
  - (ii) Should the definition of revenue and expense be limited to specific types of activities associated with operations, however described?
- (b) Are there any additional characteristics that have not been identified that you believe are essential to the development of definitions of revenues and expenses?

- (c) Are there other unique public sector revenue and expense considerations that should be considered by the IPSASB?

**Key Issues in Section 5A: Other Potential Elements: Net Assets/Net Liabilities**

*Specific Matters for Comment #13:*

- (a) Do you consider net assets/net liabilities to be a residual amount, a residual interest, or an ownership interest?
- (b) Should the concept of ownership interests, such as those that relate to minority or non-controlling positions in a GBE, be incorporated in the element definition?
- (c) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of net assets/net liabilities?

**Key Issues in Section 5B: Other Potential Elements: Transactions with Residual/Equity Participants**

*Specific Matters for Comment #14:*

- (a) Should transactions with residual/equity participants be defined as separate elements?
- (b) If defined as separate elements, should such transactions refer to interests that are able to be sold, exchanged, transferred or redeemed (excluding liability interests); that provide entitlement to distributions during the entity's life and in the event of being wound up; and/or that provide an equity or residual interest represented by a public interest in the operating capability or the capability of the entity at the reporting date to finance itself and resource future operations?

**Key Issues in Section 5C: Other Potential Elements: Deferred Outflows and Deferred Inflows**

*Specific Matters for Comment #15:*

- (a) Do deferrals need to be identified on the statement of financial position in some way?
- (b) If yes, which approach do you consider the most appropriate? Deferred outflows and deferred inflows are:
  - (i) Defined as separate elements
  - (ii) Included as sub-components of assets and liabilities
  - (iii) Included as sub-components of net assets/net liabilities
- (c) If defined as separate elements, are the definitions of a deferred outflow and deferred inflow as set out in paragraph 5.37 appropriate and complete?

**Key Issues in Section 6: Recognition**

*Specific Matters for Comment #16:*

- (a) Should recognition criteria address evidence uncertainty by including evidence thresholds (such as probable, more likely than not, or virtual certainty of an inflow or outflow of economic benefits); or by requiring a neutral judgment whether an element exists at the reporting date based on an assessment of all available evidence; or by basing the approach on the measurement attribute?
- (b) If you support the threshold approach or its use in a situational approach, do you agree that there should be uniform thresholds for both assets and liabilities? If so, what should it be? If not, what threshold is reasonable for asset recognition? For liability recognition?

*Specific Matter for Comment #17:*

Do you support the use of the same recognition criteria for initial and continuing recognition?

*Specific Matter for Comment #18:*

Do you agree that the Conceptual Framework should identify recognition criteria separately from the element definitions?

## Consultation Paper Summary: Public Sector Financial Reporting Conceptual Framework Phase II: Elements and Recognition

<p>This summary provides a brief overview of the consultation paper <i>The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities Phase II</i></p>	<p>Project Objectives</p>	<p>The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities will establish and make explicit the concepts to be applied in developing IPSASs. This consultation paper raises issues associated with the elements of general purpose financial statements and their recognition only.</p>
	<p>Project Stage</p>	<p>In September 2008 the IPSASB published the first consultation paper in this project on the objectives, the scope, and the qualitative characteristics of financial reporting and the reporting entity. The IPSASB has considered comments on this paper and issued an exposure draft. Following the consultation paper on elements and recognition, separate consultation papers are planned for Phase III: Measurement and Phase IV: Presentation and Disclosure</p>
	<p>Next steps</p>	<p>The IPSASB seeks feedback to guide the IPSASB in developing the concepts of the elements of general purpose financial statements and their recognition.</p>
	<p>Comment deadline:</p>	<p>The consultation paper is open for public comment until XX/XX 2011.</p>

## Why is the IPSASB undertaking this project?

The purpose of the IPSASB's Conceptual Framework project is to develop concepts, definitions, and principles that respond to the objectives, environment and circumstances of governments and other public sector entities and, therefore, are appropriate to guide the development of IPSASs and other documents dealing with financial reporting by public sector entities.

Many of the current IPSASs are based on International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB), to the extent that the requirements of those IFRSs are relevant to the public sector.

The IASB is currently developing an improved Conceptual Framework for private sector business entities that is being closely monitored by the IPSASB. However, development of the IPSASB's Conceptual Framework is not an IFRS convergence project, and the purpose of the IPSASB's project is not simply to interpret the application of the IASB Framework to the public sector.

The concepts underlying statistical financial reporting models, and the potential for convergence with them, will also be considered by the IPSASB in developing its Conceptual Framework. The IPSASB is committed to minimizing divergence from the statistical financial reporting models where appropriate.

Although all the components of the Conceptual Framework are interconnected, the project is being developed in phases.

To meet the objectives of financial reporting, information is needed that encompasses financial and non-financial information, prospective financial and non-financial information and reporting on compliance. Accordingly, General Purpose Financial Reports (GPFR) are broader than public sector financial statements, that are focused on the financial portrayal of past transactions and events which affect financial position at a point in time and financial performance for a specified period.

This Consultation Paper (CP) focuses just on the elements of general purpose financial statements (GPFS) of public sector entities and their recognition. Elements are the basic building blocks of financial statements needed to meet the information needs of the identified users of these financial reports. This paper considers both how these elements might be defined and what criteria might be established for their recognition.

## What tentative decisions has the IPSASB made already?

The IPSASB has made a number of tentative decisions regarding the objectives and scope of financial reporting that will be important in making further decisions about the elements of financial statements.

General Purpose Financial Reports are financial reports intended to meet the common information needs of users who are unable to command the preparation of financial reports tailored to meet their needs.

The scope of financial reporting will evolve in response to users' information needs.

GPFRs of public sector entities are broader than financial statements and their notes as currently dealt with in IPSASs. However, financial statements and their notes remain at the core of financial reporting.

The objectives of financial reporting by public sector entities are to provide information about the reporting entity useful to users of GPFRs for accountability and decision making purposes.

GPFRs of public sector entities are developed primarily to respond to the information needs of service recipients and resource providers. Those elected or appointed to represent or advise these service recipients and resource providers or that otherwise act in their interests are also primary users of GPFRs.

Service recipients will require information as input to assessments of such matters as whether:

- the entity is using resources economically, efficiently, effectively, and as intended, and whether such use is in their interests;
- the range and cost of services provided during the reporting period, and the amount and sources of their cost recoveries, are appropriate; and
- current levels of taxes, rates, or other charges are sufficient to maintain the volume and quality of services currently provided.

Resource providers will require information to enable them to form judgments about such matters as whether the entity:

- is achieving the objectives established as the justification for the resources raised during the reporting period;
- funded current operations from funds raised in the current period from taxpayers and ratepayers or from borrowings or other sources; and
- is likely to need additional (or less) resources in the future (and the likely sources of those resources).

## What are assets in public sector financial statements?

The three characteristics necessary for a complete definition of an asset relate to:

- the substance of an asset
- how to determine if it is the reporting entity's asset, and
- how to determine if it is an asset at the reporting date

### The Substance?

Is the substance of an asset the right to benefits or a tangible or intangible resource?

Must the benefits or resources be economic; i.e. scarce or restricted?

Is there an asset where economic benefits are obtained through service potential where no cash is generated; how should service potential be defined and considered?

Is there an asset where economic benefits be obtained through binding unconditional rights; how should such items as unconditional risk (insurance) protection and rights under executory contracts be considered?

### of the Reporting Entity?

What are the most appropriate criteria to use to determine if it is the reporting entity's asset:

- Control?
- Access to the rights?
- Legal or other enforceable claims to benefits?
- Ability to restrict or deny access of others to rights?
- Additional requirements necessary to establish a link?

### at Reporting Date?

Should existence at the reporting date be part of the element's definition or be identified as a separate recognition criterion?

Is it necessary to specify that an asset arises from a past transaction or event?

Where the benefits or resource develops over time, e.g. from a political promise, through legislation, through criteria being met, when is the most appropriate recognition point?

Are taxes an inherent right of governments at every reporting date, i.e. a perpetual asset or must the taxpayers meet the conditions required by the legislation before assets are considered to exist.

## What are liabilities in public sector financial statements?

	The Substance?	of the Reporting Entity?	at Reporting Date?
<p>The three characteristics necessary for a complete definition of a liability relate to:</p> <ul style="list-style-type: none"><li>• the substance of a liability</li><li>• how to determine if it is the reporting entity's liability, and</li><li>• how to determine if it is a liability at the reporting date</li></ul>	<p>Is the substance of a liability an economic obligation, even if future economic sacrifice might not be required to settle?</p> <p>Is an unconditional promise, including unconditional promises to stand ready to ensure against loss a liability?</p> <p>Is an obligation to perform in a specified manner a liability?</p> <p>Is an obligation to provide access to or forego economic resources in the future a liability?</p> <p>Is the notion of requiring settlement by a certain date useful to the definition of a liability?</p>	<p>What are the most appropriate criteria to use to decide if it is the reporting entity's liability:</p> <ul style="list-style-type: none"><li>• the entity's duty or responsibility to another entity?</li><li>• A legally enforceable contractual, constructive and equitable obligation?</li><li>• A legally enforceable contractual, constructive and equitable obligation associated with exchange transactions?</li><li>• A legally enforceable contractual, constructive and equitable obligation from which the public sector entity cannot realistically withdraw?</li></ul>	<p>Should existence at the reporting date be part of the element's definition or be identified as a separate recognition criterion?</p> <p>Is it necessary to specify that a liability arises from a past transaction or event?</p> <p>Where the obligation develops over time, e.g. from a political promise, through legislation, through criteria being met, when is the most appropriate recognition point?</p> <p>Are government responsibilities to provide social benefits inherent at every reporting date, i.e. a perpetual liability or must the claimants meet the conditions required by the legislation before liabilities are considered to exist?</p>

## How should IPSASs approach reporting Public Sector Financial Performance?

### Why report financial performance?

The statement of financial performance is used to gain an understanding of the sources, allocations and consumption of resources and claims to the resources administered by the entity during the period.

Such information facilitates assessments of the entity's resource requirements, the purposes to which resources were used and the nature and extent of its revenue raising activities.

The net results over the period provide a measure of whether the revenues recognized were sufficient to meet the costs incurred during the period.

### Two underlying concepts?

Two different conceptual views underlie what is meant by financial performance. Different definitions of the elements related to financial performance and financial position may result from these views.

One approach measures financial performance as the net result of all changes in the entity's economic resources and obligations during the period (asset and liability-led view),

The other approach measures financial performance as the result of the revenue inflows and expense outflows more closely associated with the efforts of the current period (revenue and expense-led approach)

### Implications?

Different approaches to financial performance result in different definitions of revenue and expense elements.

This, in turn, may suggest the need to define other financial position elements, such as deferred items.

Hybrid approaches that contain attributes of both conceptual views may be able to be developed either through element definition or financial statement presentation.

Therefore IPSASB needs to determine if the measure of financial performance should be based on a process of allocating inflows and outflows to particular periods (a revenue and expense-led approach) or based on changes in the period in the net economic resources/ obligations of an entity (an asset and liability-led approach) and whether or how those approaches can be reconciled.

## What are revenues and expenses in public sector financial statements?

The most critical issue is how revenues and expenses should be associated with the reporting period: an association based on changes in assets and liabilities during the period, or an association with the goods and services provided in the period and the taxes levied and other inflows generated to cover the cost of those goods and services.

Based on changes in assets or liabilities?

The measure of financial performance is grounded in terms of real economic phenomena. Assets and liabilities represent economic resources and obligations that can be observed and verified directly.

All items that represent changes in the net resources of the entity between the financial reporting dates are included in the measure of financial performance, resulting in a relevant and reliable metric to assess accountability.

Judgment is not required to determine which transactions and events affecting financial position are included or excluded from any specific period's measure of financial performance.

Artificial smoothing of periodic results is avoided.

Based on association with goods and services provided in the period?

The focus on current operations increases the relevance of the statement measuring financial performance.

Gains and losses from unexpected and non-controllable peripheral events may be included in the current period's results or may be accounted for according to the government policies adopted at the time, rather than being reflected in full in the measurement of the period's surplus/deficit.

Because a public sector entity is accountable for raising revenue and the uses to which it is put, this should be the primary indicator of the financial performance of the entity.

Difficult subjective judgments as to whether assets or liabilities presently exist should not necessarily impact on measures of financial performance.

Other revenue and expense issues?

Whether transactions with residual interest/equity participants should be excluded from the definitions?

Whether revenue and expenses should be restricted to the results of specific activities?

## Other elements needed in public sector financial statements?

	Net Assets/Net Liabilities?	Transactions with Residual Interests?	Deferred Outflows and Deferred Inflows?
Aside from the four fundamental elements; assets liabilities, revenues and expenses, what other items are required to be separately identified as an element in order to provide all the required building blocks for a public sector entity's general purpose financial statements?	<p>Do net assets/net liabilities simply represent a residual amount?</p> <p>Is there an interest in net assets/net liabilities?</p> <p>If there is an interest, is that an ownership interest? or</p> <p>If there is an interest, is that a financial interest of resource providers and service recipients in the capability of the entity to finance itself and resource future operations?</p>	<p>Can contributions or distributions by external parties be made directly to net assets/liabilities without being a revenue or expense?</p> <p>Is it necessary for the contribution or distribution to establish or reduce a financial interest in the net assets of the entity?</p> <p>Is it necessary for a contribution to convey entitlement to distributions of future economic benefits or service potential and to distributions of any excess of assets over liabilities in the event of the entity being wound up?</p> <p>Is it necessary for the interest to be able to be sold, exchanged, transferred or redeemed?</p>	<p>If revenues and expenses are to be defined with a characteristic that indicates they are “applicable to” the reporting period, and the financial position and financial performance statements are to articulate, then which of the following approaches is most appropriate?:</p> <ul style="list-style-type: none"><li>• Define deferred outflows and deferred inflows as separate elements on the statement of financial position</li><li>• Broaden the definitions of asset and liability elements to encompass items that are deferrals</li><li>• Describe the deferred outflows and deferred inflows as sub-classifications of net assets/net liabilities.</li></ul>

## Recognition criteria for public sector financial statements?

Recognition is the process of incorporating an item that meets the definition of an element and can be measured reliably in the relevant financial statement.

Recognition involves the depiction of the item in words and by a monetary amount and the inclusion of the item's value (that amount), in aggregates or, on rare occasions, as a discrete line item on the face of a financial statement.

An item must meet both the definition of a particular element and the recognition criteria in order to be recognized.

### Existence Uncertainty

Because entities operate in uncertain environments, it may be difficult to determine whether a transaction or event creates an item that meets the definition of an element.

Which approaches to dealing with existence uncertainty is the most appropriate?

- Standardized threshold criteria, for example, recognize only if it is "probable" that future economic benefits associated with the item will flow to or from the entity.
- Use all available evidence to make neutral judgments about the element's existence, based on an understanding of all available facts and circumstances. If it is determined that an element exists, take uncertainty into account in measurement.
- Use threshold criteria or neutral judgments; a situational approach depending on the underlying measurement basis of the element.

### Measurement Uncertainty

There is inevitably a degree of uncertainty associated with the measurement of many financial statement amounts. The use of estimates is an essential part of the accrual basis of accounting.

The amount recognized must satisfy the qualitative characteristics of faithful representation and reliability. This is often a matter for professional judgment.

The selection of a measurement basis is considered in Phase III of the Conceptual Framework project.

## What happens now?

### **The deadline for comments is xx/xx 2011.**

During the comment period, IPSASB members are available to discuss the proposals with a wide range of parties.

### **How can I comment on the proposals?**

The consultation paper includes questions on the issues. IPSASB has not provided tentative views on the issues so as to get the widest possible consultation.

Respondents may choose to answer all or just selected questions and are also welcome to comment on any other matter they think the IPSASB should consider in forming its views.

Comment letters will be posted on IPSASB's website.

The IPSASB will consider carefully all feedback and, as usual, discuss responses to the proposals in public meetings. The

IPSASB plans to issue an exposure draft setting out its views in late 2011.

### **Stay informed**

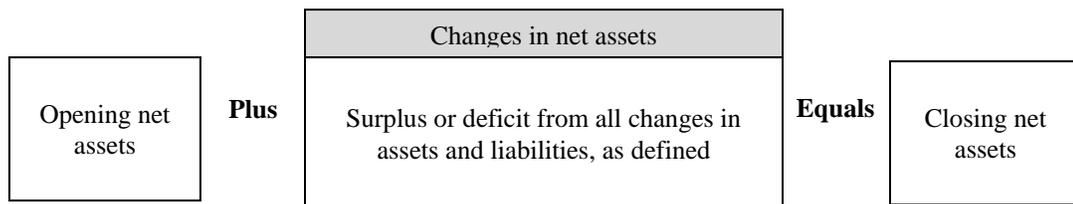
The IPSASB will announce on its website the dates and places of meetings at which it will discuss feedback to this consultation paper.

To stay up to date about the project, you can monitor progress reported at <http://www.ifac.org/PublicSector/ProjectHistory.php?ProjID=0066>

## Alternative Financial Reporting Models

- A1.1 Four basic reporting approaches currently in use for determining surplus/deficit have been identified:
- (a) Change in Accumulated Surplus or Deficit (CASD) approach
  - (b) Government Finance Statistics (GFS) approach
  - (c) Net Cost of Services (NCS) approach
  - (d) Inter-Period Equity (IPE) approach
- A1.2 The basic concepts in all four approaches are similar in terms of assets and liabilities and their respective definitions. However, there are differences in the determination of surplus or deficit under the alternative approaches. Each approach treats various items, such as revaluations of property, plant and equipment, financial instruments, foreign currency translation and price changes somewhat differently.
- A1.3 The diagrams and brief descriptions below provide a basic overview of the four approaches and illustrate how certain items are treated in the determination of surplus or deficit. The opening financial position, plus the specific presentation of transactions and other events during the period within each approach, result in a closing position.

### (a) Change in Accumulated Surplus or Deficit Approach



**CASD:** The *Change in Accumulated Surplus or Deficit* approach focuses on presenting all changes in net assets for a period in one performance statement. It does not distinguish between different types of performance. Under this approach, all transactions and other events, such as revaluation, exchange rate and fair value changes are included in surplus or deficit.

- A1.4 This approach includes all flows, with the exception of flows with equity participants, as a revenue or expense. It treats any components of revenue and expense as a matter of presentation, not of element definition. It defines surplus or deficit simply as changes in net assets, other than transactions with owners.

### Rationale for the Approach

- A1.5 Net assets can be increased or decreased only by transactions with owners or from the operations of a public sector entity. This approach explains that all changes in

net assets, other than transactions with owners, are part of the operations of the entity or its surplus or deficit. All transactions and events that meet the definitions of revenue and expenses are presented as part of surplus or deficit therefore eliminating the judgment required in deciding whether or not an item is included in operating surplus or other economic flows.

**Description of the Approach**

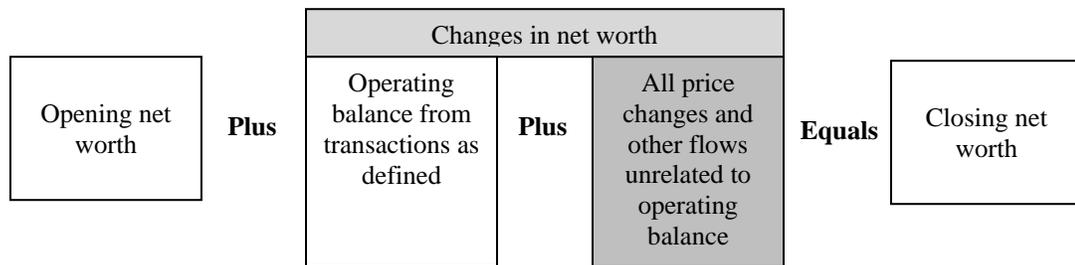
A1.6 The Statement of Financial Position includes assets and liabilities, and net assets, which is the difference between assets and liabilities.

- Assets are generally described as resources controlled by a public sector entity.
- Liabilities are generally described as present obligations to sacrifice resources.

A1.7 The Statement of Financial Performance records all of the changes in assets and liabilities that affect a change in net assets without requiring a separate presentation of the types of revenue or expense.

- Revenue would be defined as increases in assets or decreases in liabilities.
- Expenses would be defined as decreases in assets or increases in liabilities.

**(b) Government Finance Statistics Approach**



**GFS:** The *Government Finance Statistics* approach focuses on the economic flows in an economy. It separately analyzes these flows into transactions and other economic flows. Under this approach, operating balance is determined by operating revenue and expense transactions. Other changes in net worth that are not part of operating balance, are considered as other economic inflows and outflows; i.e., those arising from non-operating transactions and price changes related to, for example, financial instruments. These amounts are presented in a separate Statement of Other Economic Flows. Together, the Statement of Operations and the Statement of Other Economic Flows explain changes in net worth.

A1.8 The GFS approach is based on the System of National Accounts (SNA), with some minor variations and exceptions. The SNA is the internationally agreed standard set of recommendations on how to compile measures of economic activity designed for economic analysis, decision-taking and policy-making. The

SNA collects data for the purposes of analysing and evaluating the performance of an entire economy. Included in its scope are non-financial corporations, financial corporations, government units, non-profit institutions, households, and interactions with the rest of the world. It is used for monitoring the behaviour of the economy, macroeconomic analysis and for making international comparisons.

- A1.9 The GFS system is intended to provide similar statistical analyses to the SNA, but is limited in scope to public sector entities (called public units in the SNA). It provides public finance analysts with the ability to make assessments about such things as the size of the public sector, its contribution to aggregate demand, investment, and saving; the impact of fiscal policy on the economy, including resource use, monetary conditions and national indebtedness; the tax burden; tariff protection; and the social safety net. In addition, analysts have become increasingly interested in assessing the sustainability of fiscal policies, net debt, net wealth, and future claims, including social security pensions.

### **Rationale for the Approach**

- A1.10 The GFS approach provides an analytic framework for the consistent presentation of fiscal statistics which are suitable for analyzing and evaluating fiscal policy, especially the performance of public units in an economy.

### **Description of the Approach**

- A1.11 The GFS Balance Sheet presents assets, liabilities, and the reporting entity's net worth, which is the residual between the value of all assets and liabilities. In accounting terms, net worth is equivalent to accumulated surplus or deficit. GFS also provides a sub-category for another measure of net worth: net financial worth, which is the difference between financial assets and all liabilities.

- Assets (both financial and non-financial assets) are generally described as those items where the reporting entity enforces ownership rights over the asset from which economic benefits may be derived by holding or using those assets.
- Liabilities are described as obligations to provide economic benefits to others that hold a corresponding financial claim. Shares and other equity items are treated as financial claims even though the holders of those claims do not have a fixed or predetermined monetary claim on the entity.

- A1.12 The Statement of Operations presents the flows or changes in the stocks of assets and liabilities that result from all transactions during the accounting period which affect a change in net worth.

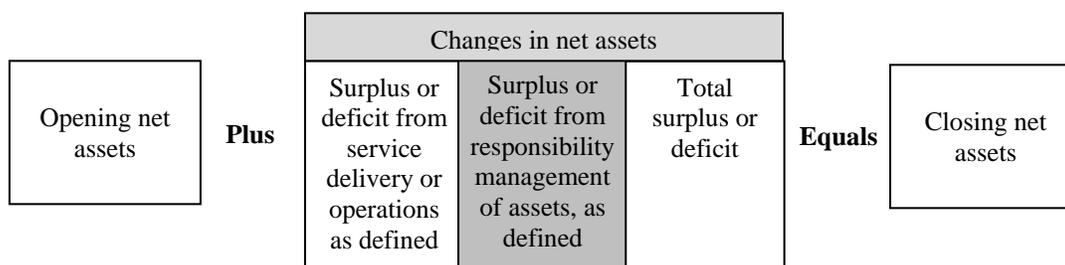
- Revenue is defined as those increases in net worth that result from transactions.
- Expenses are defined as those decreases in net worth resulting from a transaction. Note that changes in the liability for retirement schemes

resulting from changes in the benefit structure are not included in expenses.

A1.13 The Statement of Other Economic Flows presents the changes in net worth that result from price changes (holding gains and losses) and a variety of other economic flows that affect the value of recognized assets and liabilities as a result of holding them.

- A holding gain or loss results from a change in price including gains and losses from changes in exchange rates.
- Other economic flows representing changes in the volume of assets and liabilities include:
  - Recognition or derecognition caused from changes in relative prices, technology or some other event.
  - Changes in the quality or quantity of assets and liabilities such as damage to assets caused by an earthquake or volcanic eruption; reduction in the volume of mineral deposits due to the availability of more accurate information; amortization of certain intangible assets; and changes in the liability for retirement schemes resulting from changes in the benefit structure.

**(c) Net Cost of Services Approach**



**NCS:** The *Net Cost of Services* approach focuses on separately presenting performance between the results (surplus or deficit) from the delivery of services or operations from the results (surplus or deficit) arising from the responsibility for and management of assets and liabilities. For example, interest on outstanding debt, revaluations, exchange rate and fair value changes are examples of the latter. All changes in net assets, i.e., net surplus or deficit from both sources are presented in one performance statement.

A1.14 Under this approach, a public sector entity measures a period’s financial performance by determining which revenues and expenses are related to the delivery of services or operations, i.e., outputs. Revenues and expenses that are not related to the delivery of services or operations are presumed to be related to the responsibility for and management of assets and liabilities. The total of surplus or deficit relating to service delivery in addition to the total related to

responsibility for and management of assets liabilities and explains all changes in net assets.

### **Rationale for the Approach**

A1.15 Citizens and others as recipients of services are likely to require information on the quantity, quality and cost of services delivered. To enhance understandability for these users, financial performance relating to the cost of the services provided and the revenue received to perform those services is presented separately.

A1.16 Citizens and others as providers of the resources of public sector entities wish to ensure that assets are used efficiently, and that the entity maintains its capacity to provide services efficiently in future years. The financial effect of decisions that an entity makes in respect of its assets and liabilities needs to be separated from the delivery of services so that a separate assessment can be made as to the entity's management of those assets and liabilities. An example of responsibility for and management of assets is an increase or decrease in the value of housing stock owned due to changes in demand as economic conditions change.

### **Description of the Approach**

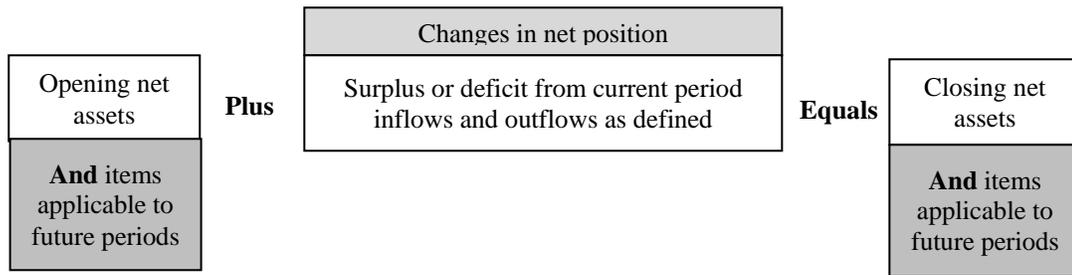
A1.17 The Statement of Financial Position includes assets and liabilities, and net assets, which is the residual difference between assets and liabilities.

- Assets are generally described as resources controlled by a public sector entity.
- Liabilities are generally described as present obligations to sacrifice resources.

A1.18 The Statement of Financial Performance records all of the changes in assets and liabilities that result in a change in net assets, separately presenting:

- Revenue from service delivery or operations, generally defined as those increases in assets or decreases in liabilities arising from operations.
- Revenue from responsibility for and management of assets and liabilities, generally defined as increases in assets or decreases in liabilities not arising from service delivery or operations.
- Expenses from service delivery or operations, generally defined as decreases in assets or increases in liabilities arising from service delivery or operations.
- Expenses from ownership and management of assets and liabilities, generally defined as decreases in assets or increases in liabilities not arising from service delivery or operations.

(d) **Inter-Period Equity Approach**



**IPE:** The *Inter-Period Equity* approach provides information to determine whether current-year revenues were sufficient to pay for current year services. It focuses on presenting information to assist users to determine whether or not the burden of the current year cost of services is borne by current, past or future year taxpayers and revenue providers. It defines net assets/equity as the difference between assets, liabilities and deferred inflows and outflows. Under this approach, surplus or deficit is determined from all changes in net position, thus requiring only one performance statement.

**Rationale for the Approach**

A1.19 This approach reflects the view that a public sector entity must first answer to its citizenry to explain the raising of public resources and the purposes to which those resources have been put. Reporting to them on the resources available to the public sector entity and the claims on those resources is secondary to that primary purpose.

A1.20 The IPE approach attributes costs of the services to the period in which those services were provided and attributes revenues provided by taxpayers and other revenue providers to the appropriate period for the purpose of assessing whether those revenues were sufficient to finance the costs of providing services during that period. IPE is a relevant concept for assessing accountability and decision usefulness as it demonstrates whether revenues were sufficient to meet the costs of the services provided in the period. For users of financial statements, the concept of IPE may be useful because it demonstrates the effects of fiscal decisions made today that have implications for the future.

**Description**

A1.21 The Balance Sheet presents net position as the difference between assets, deferred outflows, liabilities and deferred inflows. IPE introduces two additional elements:

*Deferred outflows* are generally described as a consumption of assets and increases in liabilities by the entity that is applicable to a future period. Typical types of deferred outflows include bond issuance costs or contributions for services to be provided over multiple future periods.

*Deferred inflows* are generally described as an increase in assets and decrease in liabilities of the entity applicable to future periods. Deferred inflows include sales of future revenues, e.g., amounts expected to be collected from future tax collections.

A1.22 The Statement of Inflows and Outflows records the changes that affect the net position. It does not include inflows and outflows that are applicable to future periods, but only those that are applicable to the current period. These items are treated as deferred outflows and deferred inflows.

- Inflows are generally defined as those increases in net assets that are applicable to the current period.
- Outflows are generally defined as those decreases in net assets that are applicable to the current period.

### **Summary and Evaluation of Models: Element Definition and Presentation Perspective**

A1.23 The basic concepts in all four approaches are similar in terms of assets and liabilities and their respective definitions. However, there are differences based on the conceptual view taken. Three of the views take an asset and liability-led approach but the presentation of financial performance in terms of what is reported as the surplus or deficit is different. Each approach treats various items, such as revaluations of property, plant and equipment, financial instruments, foreign currency translation and price changes somewhat differently. One view is a hybrid model based on the revenue expense-led view. It continues to recognize assets and liabilities as economic resources and obligations, but introduces deferred items into the statement of financial position to address the issue of measuring financial performance.

A1.24 Financial statement presentation can also affect the elements that need to be defined and the basis for their definition. This is illustrated in the discussion that follows.

#### **Summary Table of the Four Approaches**

	<b>CASD</b>	<b>GFS</b>	<b>NCS</b>	<b>IPE</b>
<b>Bottom-line result reported</b>	Results of increases or decreases in net assets/equity	Results of transactions and other economic flows	Results from the delivery of services and from the management of resources and claims	Results in terms of the extent that the burden of the current year cost of services is borne by current, past or future year resource providers
<b>Objective</b>	To show users how the financial and operating capacity	To show users how transactions with third parties and	To show users how operating activity and asset and	To show whether current resource providers have

	of the entity has changed over the year	other events, respectively, have changed the financial and operating capacity of the entity over the year	liability management, respectively, have changed the financial and operating capacity of the entity over the year	provided sufficient revenue to meet the costs incurred in the delivery of benefits and services over the year.
<b>Conceptual View</b>	Asset and Liability	Asset and Liability but with measurement and other economic flows presented separately	Asset and Liability but with performance flows presented in two sections: flows related to services and programs reported separately from flows related to the management of assets and liabilities	Revenue and Expense
<b>Approach</b>	Single comprehensive financial performance statement	Two statements: one on transaction flows and one on other economic flows	One statement in two parts: net cost of services and asset and liability management	One financial performance statement with deferred items included in addition to assets and liabilities on the statement of financial position.

A1.25 The CASD approach defines assets and liabilities first. It focuses on presenting all changes in net assets for the period in one performance statement. All transactions and other events, such as revaluations, exchange rate and fair value changes are considered aspects of financial performance and are included in surplus or deficit. It does not distinguish between different types of performance. The division of this statement into various sub-components is considered a matter of presentation rather than one of elements. This approach is consistent with the current definitions of revenue, expense, assets and liabilities.

A1.26 The GFS approach defines assets and liabilities first and separates revenues and expenses into two components, dependent on whether they affect operating performance. The operating balance is determined by operating revenue and expense transactions. Assets are described as those items where the reporting entity enforces ownership rights from which economic benefits may be derived by holding or using those assets. GFS may result in differences arising from applying an “enforcement of ownership rights” approach. Liabilities are obligations to provide economic benefits to units or individuals holding the corresponding “financial claim.” This approach may have implications for things such as environmental obligations or asset retirement obligations where no other party

- presently has a corresponding financial claim on resources. Existing definitions of revenue and expense would need to reflect the transaction based approach.
- A1.27 The NCS approach defines assets and liabilities first, but separates revenues and expenses into two components, reporting them both on one financial performance statement. These classifications do not affect the definitions of elements because the classification is made after the transaction or other event is identified as revenue or expense. Similarly, this approach does not affect the definitions of assets and liabilities.
- A1.28 The IPE approach defines revenue and expenses separately. It defines net position as the residual difference between assets, liabilities, and deferred inflows and outflows. The surplus or deficit is determined from all changes in net position, thus requiring only one performance statement. Because assets and liabilities are defined independently of revenues and expenses, this approach is known as a hybrid method. However, additional elements are required to address the items included in deferred inflows and outflows. The definitions of revenue and expense would also need to reflect that they include only those items of revenue or expense that apply to the current period.
- A1.29 The main arguments for the first and fourth approaches above have been set out in Section 1 of the Consultation Paper where the A&L and R&E approaches were evaluated. The second and third approaches, derived from national accounting and public management literatures respectively, provide options for consideration that lie between those two competing views.
- A1.30 Both the second and third approaches separate flows that are due to remeasurement from operational transactions. In doing so they respond to concerns that it is useful to differentiate between the causes of some changes in assets and liabilities. On the other hand, both of these approaches recognise all flows that affect assets and liabilities. A flow affecting assets and liabilities is not excluded or deferred because it may be attributable to a future year.
- A1.31 The separation of transactions from other economic flows has the advantage of being relatively easy to apply and therefore less judgment is required. This results in greater comparability between entities. Because macroeconomic analysis focuses on transactions, this presentation provides a basis for fiscal analysis in determining and separately displaying the types of inflows and outflows.
- A1.32 However, there is an imperfect distinction between “transactions” and “operations” which could create difficulties in interpreting the reported results from the perspective of service recipients and resource providers. For example, the decision to write down a loan to its fair value is treated as an “other economic flow.” However the loss due to a decision to forgive a loan, or to provide a loan with concessional terms, which users may regard as an operational item is also reported as an “other economic flow.”
- A1.33 The benefit of the third approach is that an entity’s performance relating to its delivery of services is reported separately, making it easier for users to assess that

aspect of its performance. The net cost of services provides a benchmark against which the benefits of services delivered can be compared. Separately presenting the revenues and expenses that arise from the responsibility for and management of assets and liabilities assists users in understanding the entity's decisions.

- A1.34 A challenge with the third approach, however, is determining whether a transaction or other event is related to the delivery of services or from the responsibility for and management of assets and liabilities. For example, a decision to discontinue a significant group of activities is likely to result in restructuring costs that are appropriately reported as asset management costs. Similar costs involved in improving or realigning a group of activities, on the other hand, may be more properly considered part of the ongoing cost of services. Judgment is likely to be required, and this would be a standards level issue.
- A1.35 The third approach also provides a summary of all transactions and events that affect net assets. It demonstrates a type of inter-period equity from the perspective of presenting the costs of services provided and the revenue generated in the period to finance those costs. However, revenues or expenses that relate to future periods but do not meet the definition of an asset or a liability will not be recognized in the statement of financial position as deferred outflows or deferred inflows.