



INTERNATIONAL FEDERATION
OF ACCOUNTANTS

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Agenda Item 3C

Date: November 24, 2011
Memo to: Members of the IPSASB
From: John Stanford and Alister Mason
Subject: Review of Submissions to Phase 2 Consultation Paper: *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements*

Objectives of this Session

1. The objectives of this session are:
 - To carry out a further review of responses to the Conceptual Framework Phase 2 Consultation Paper, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements* (CF–CP2); and
 - To obtain directions on the approach to be adopted in forthcoming Exposure Draft on Phase 2 (CF–ED2).

Action Required

2. The IPSASB is asked to:
 - **Consider** the issues identified in the agenda material and staff views, and provide directions for the further development of the Framework; and
 - **Identify** the issues on which the TBG should focus particular attention in drafting the CF–ED2 for consideration at the March 2012 meeting.

Agenda Material

3. Agenda material attached to this memorandum:
 - 3C.1 Issues Paper, *Themes for Analysis of Responses to SMCs*;
 - 3C.2 Extract of the draft minutes of the September meeting.Other relevant materials previously distributed for the September 2011 IPSASB meeting:
 - A copy of the Phase 2 Consultation Paper (CF–CP2), *Elements and Recognition in Financial Statements*;
 - A copy of all submissions received;
 - Overview of responses by geographic location, function and language; and

- Staff summary and collation of responses received.

Background

4. CF–CP2 was approved at the IPSASB’s November 2010 meeting and issued on December 15, 2010 with a consultation period that expired on June 15, 2011. CF–CP2 contained 19 Specific Matters for Comment (SMCs). A number of these SMCs contained two or more questions. In total there were 38 questions.
5. For the September 2011 meeting, Staff prepared a summary, collation and preliminary analysis of the 35 responses to CF–CP2 that had been received by late August 2011. A further response received in September 2011 has been posted on the website as Response 36. Staff has not modified the summary and collation. Staff has considered the points in this submission and it has informed the analysis for this meeting.
6. At the September 2011 meeting the Board carried out a preliminary review of the 35 responses. The Board considered the questions which appeared to be less contentious, and reached a tentative agreement on 18 of them. It was agreed that the other 20 questions were to be carried forward for consideration at subsequent meetings. It was recognized that a number of questions considered similar or inter-related issues. Therefore the Board directed that, rather than consider the questions sequentially as they appeared in CF–CP2, they would be organized into themes and directed Staff, in consultation with Task Based Group 2 (TBG 2), to determine the appropriate themes.

Grouping of Questions into Themes

7. Staff and TBG 2 determined that the SMCs should be grouped under the following six themes:
 - Theme 1: Determining applicability to the period.
 - Theme 2: Duties, responsibilities, powers and rights.
 - Theme 3: Asset and liability definitions – past events and other attributes.
 - Theme 4: Concepts of capital and capital maintenance.
 - Theme 5: Recognition and derecognition.
 - Theme 6: Residual/equity interests and ownership interests.
8. The themes reflect the TBG’s view of how the SMCs can be organized in a manageable way. The SMCs and parts of SMCs that are within each theme are listed in Appendix A, together with an indication of whether they are to be addressed at this meeting, in March 2012, or if a tentative view had been reached in September and the substance of that tentative view. The high level position is summarized in Appendix B. The relevant preliminary analyses prepared for the September meeting for the questions that are considered at this meeting have been included as appendices to the relevant theme at Agenda Item 3C.1. It is not intended to redeliberate the September material.

9. TBG 2 does not think it will be feasible to cover all 20 outstanding questions in the time allotted on the agenda for this meeting. However, TBG 2 believes that the remaining five questions can be covered at the March meeting, in conjunction with the initial discussion of CF–ED2.
10. The remaining five questions relate to (i) enforceability of claims to benefits or the ability to deny, restrict or otherwise regulate external access in the context of an asset (Theme 2); (ii) aspects of the definitions of assets and liabilities (Theme 3); and (iii) transactions with residual/equity interests and ownership interests (Theme 6). The approach on all the SMCs on Recognition and Derecognition in Theme 5 was agreed in September. Therefore, it is not intended to consider Theme 5 further at this meeting.

Approach at the Brasilia Meeting

11. The four themes that will be discussed at the meeting will each be led by a member of the TBG as follows:
 - Theme 1: Ron Salole.
 - Theme 2: Ian Carruthers.
 - Theme 3: David Bean.
 - Theme 4: Ken Warren.

Convergence with the IASB

12. Agenda Item 3B.0 has noted that in the context of CF–ED1 “a number of respondents commented on the relationship of the IPSASB and IASB Frameworks. Some noted the desirability of a single or substantially the same Framework, and the importance of the IPSASB and IASB working together such that the IPSASB Framework and IASB Frameworks only differ because of differences in the private and public sectors.” Several respondents to CF–CP2 also expressed reservations about options that appeared to diverge from the current IASB Framework. Staff acknowledges the views of those who caution against the creation of significant differences from the IASB Framework. Staff has responded to the IASB Agenda Consultation suggesting that the IASB’s Conceptual Framework project should be reactivated and prioritized. However, Staff notes that the Framework is not an IFRS convergence project, and that the purpose of the project is not to interpret the IASB Framework for the public sector. Staff therefore considers that the IPSASB’s intention needs to be borne in mind when evaluating some of the comments made by respondents whose principal consideration was the potential divergence of the Framework from the IASB Framework.

Next Steps

13. A preliminary draft of an Exposure Draft will be brought to the March 2012 meeting.

Appendix A: Allocation of SMCs to Themes

THEME 1: DETERMINING APPLICABILITY TO THE PERIOD

SMCs to Which this Theme Applies

1. This theme comprises the SMCs from CF–CP2 that relate to the determination of revenues and expenses for a reporting period.
2. Six of the seven questions to which this theme applies are to be discussed at the December meeting. For the seventh – SMC 13(a) – in September the IPSASB confirmed Staff’s view that no additional characteristics that are essential to the definitions of revenues and expenses had been identified.
3. The six questions that are to be discussed in December are:

SMC 11(a) and (b): Approach to Determining Revenues and Expenses

- (a) *Should revenues and expenses be determined by identifying which inflows and outflows are “applicable to” the current period (derived from a revenue and expense-led approach), or by changes in net assets, defined as resources and obligations, “during” the current period (derived from an asset and liability-led approach)?*
- (b) *What arguments do you consider most important in coming to your decision on the preferred approach?*

SMC 14(a), (b) and (c): Need to Identify Deferrals on the Statement of Financial Position?

- (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 should be:*
 - (i) *Defined as separate elements;*
 - (ii) *Included as sub-components of assets and liabilities; or*
 - (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 5.8 appropriate and complete?*

[The two definitions in paragraph 5.8 of CF–CP2 are:

- (i) Deferred outflow (of resources): an entity’s consumption or reduction of new assets that is applicable to a future reporting period.
- (ii) Deferred inflow (of resources): an entity’s increase or acquisition of net assets that is applicable to a future reporting period.]

SMC 13(b): Additional Characteristics/Issues re Revenues and Expenses

Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the definitions of revenues and expenses?

THEME 2: DUTIES, RESPONSIBILITIES, POWERS AND RIGHTS

1. This theme comprises the SMCs from CF–CP2 relating to (i) enforceability and the related issue of (ii) what constitutes a realistic alternative to avoiding an obligation. It also includes (iii) what assumptions, if any, about sovereign power should be included in the development of the definition of a liability and (iv) governmental powers, rights and obligations. There is a strong linkage between this theme and the discussion of a past event in Theme 3.
2. Six of the seven questions to which this theme applies are to be discussed at the December meeting; none were agreed in September. The remaining one is to be carried forward to March.

A. Questions to be Discussed at the December 2011 Meeting of the IPSASB

SMC 7(b): Absence of Realistic Alternative to Avoid Obligation Needed to Define Liability?

Do you agree that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability?

SMC 7(c): Approach to Determining Realistic Alternative to Avoid Obligation?

Which of the three approaches identified in paragraph 3.28 do you support in determining whether an entity has or has not a realistic alternative to avoid the obligation?

[The three approaches identified in paragraph 3.28 of the CP are:

- (a) Enforceable contractual, constructive, and equitable obligations.
- (b) Enforceable contractual, constructive, and equitable obligations and other constructive and equitable obligations associated with exchange transactions.
- (c) Enforceable contractual, constructive, and equitable obligations and all other constructive and equitable obligations from which the public sector entity cannot realistically withdraw.]

SMC 9(a): Public Sector Obligations Arise only from Enforceable Claims?

Recognition and measurement criteria aside, are public sector entity obligations such as those associated with its duties and responsibilities as a government, perpetual obligations, obligations only when they are enforceable claims, or is there an appropriate intermediate event that is more appropriate?

SMC 9(b): Enforceability Essential Characteristic of Liability?

Is the enforceability of an obligation an essential characteristic of a liability?

SMC 9(c): Definition of Liability includes Assumption about Sovereign Power?

Should the definition of a liability include an assumption about the role that sovereign power plays, such as by reference to the legal position at the reporting date?

SMC 4: Public Sector Rights/Powers Inherent Assets?

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, are they assets only when those powers are exercised, or is there an intermediate event that is more appropriate?

B. Question to be Deferred to the March 2012 Meeting

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

Does an entity's enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others' access link a resource to a specific entity?

THEME 3: ASSET AND LIABILITY DEFINITIONS – PAST EVENTS AND OTHER ATTRIBUTES

1. This theme comprises the SMCs relating to the necessity of identifying a past event in the definition of an asset and a liability and other attributes of the definition of an asset and a liability.

A. Questions to be Discussed at the December 2011 Meeting of the IPSASB

SMC 3: Past Event Necessary to Definition of an Asset?

Is it sufficient to state that an asset is a “present” resource, or must there be a past event that occurs?

SMC 8: Past Event Necessary to Definition of a Liability?

Is it sufficient to state that a liability is a “present” obligation, or must there be a past event that occurs?

B. Questions to be Deferred to the March 2012 Meeting

SMC 1(a): Definition of Asset

Should the definition of an asset cover all of the following types of benefits—those in the form of:

- (i) *Service potential;*
- (ii) *Net cash inflows; and*
- (iii) *Unconditional rights to receive resources?*

SMC 6(a): Definition of Liability

Should the definition of a liability cover all of the following types of obligations?

- (i) *Obligations to transfer benefits, defined as cash and other assets, and the provision of goods and services in the future.*
- (ii) *Unconditional obligations, including unconditional obligations to stand ready to insure against loss (risk protection).*
- (iii) *Performance obligations.*
- (iv) *Obligations to provide access to or forego future resources.*

C. Those on Which Agreement was Reached at September 2011 Meeting

SMC 1(b): Service Potential and/or Economic Benefits

What term should be used in the definition of an asset:

- (i) *Economic benefits and service potential; or*
- (ii) *Economic benefits?*

The IPSASB confirmed Staff's view that both economic benefits and service potential should be used in the definition of an asset. There was tentative agreement that the wording to be adopted will be "service potential and/or economic benefits". [Note: Andrew Lennard, lead author of CF-CP3 would like to partially re-open this question. Andrew proposes the term "economic benefits including service potential" and will explain his reasons at the meeting.]

SMC 2(a): Which Approach Associates Asset with Specific Entity?

Which approach do you believe should be used to associate an asset with a specific entity:

- (i) *Control;*
- (ii) *Risks and rewards; or*
- (iii) *Access to rights, including the right to restrict or deny others' access to rights?*

The IPSASB tentatively confirmed Staff's view that control should be used as the primary criterion for associating an asset with a specific entity.

SMC 2(c): Additional Requirements Needed to Link Asset to Entity?

Are there additional requirements necessary to establish a link between the entity and an asset?

The IPSASB tentatively confirmed Staff's view that no additional requirements are necessary.

SMC 6(b): Settlement Date Essential Characteristic of Liability?

Is the requirement for a settlement date an essential characteristic of a liability?

The IPSASB confirmed Staff's view that the requirement for a settlement date is not an essential characteristic of the definition of a liability.

SMC 7(a): Specific External Party Needed to Define Liability?

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?

The IPSASB confirmed Staff's view that the ability to identify a specific outside party(ies) is not an essential characteristic of the definition of a liability.

SMC 5(a) and (b): Additional Characteristics/Issues re: Assets?

- (a) *Are there any additional characteristics that have not been identified that you believe are essential to the development of an asset definition?*

The IPSASB confirmed Staff's view that no additional characteristics essential to an asset definition had been identified.

- (b) *Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of assets?*

The IPSASB confirmed Staff's view that there are no other relevant issues that need to be considered in determining the concept of assets.

SMC 10(a) and (b): Additional Characteristics/Issues re: Liabilities?

- (a) *Are there any additional characteristics that have not been identified that you believe are essential to the development of a liability definition?*

The IPSASB confirmed Staff's view that no additional characteristics are essential to 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?*

The IPSASB confirmed Staff's view that there are no other relevant issues that need to be considered in determining the concept of liabilities.

THEME 4: CONCEPTS OF CAPITAL AND CAPITAL MAINTENANCE

1. This theme comprises the five SMCs from CF–CP2 that relate to the inclusion of items in net assets or equity in the statement of financial position of an entity. It also includes the issue of whether revenues and expenses should be limited to operational activities. However, it excludes the two SMCs that relate to (a) the exclusion of transactions with residual/equity interests from revenues/expenses and (b) the concept of ownership interests not being in the ownership definition. (These two SMCs are in Theme 6, to be considered at the March 2012 meeting.)
2. At its September meeting the IPSASB considered SMC 15(c) – Other issues relevant to net assets/net liabilities? The IPSASB agreed that no other issues relevant to net assets/net liabilities had been identified.
3. The four questions, for which decisions are requested in December, are:

SMC 12(b): Limiting Definitions of Revenue and Expenses to Specific Types of Activities?

Should the definitions of revenue and expense be limited to specific types of activities associated with operations, however described?

SMC 15(a): Net Assets/Net Liabilities and Ownership Interests

Do you consider net assets/net liabilities to be a residual amount, a residual interest, or an ownership interest?

SMC 16(a) and (b): Transactions with Residual/Equity Interests

- (a) *Should transactions with residual/equity interests be defined as separate elements?*
- (b) *If defined as separate elements, what characteristics would you consider essential to their definition*

THEME 5: RECOGNITION

1. This theme comprises the three SMCs that deal with (i) recognition, (ii) derecognition and (iii) whether recognition criteria should be incorporated in element definitions. Tentative agreement was reached on all these SMCs at the September meeting:

SMC 17(a) and (b): Recognition Criteria

- (a) *Should recognition criteria address evidence uncertainty by requiring evidence thresholds; 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?*

The IPSASB confirmed Staff's view that a neutral judgment should be applied in assessing whether an element exists at the reporting date, based on an assessment of all available evidence.

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

Since the IPSASB supported the use of neutral judgment, no decision was required on thresholds.

SMC 18: Derecognition

Do you support the use of the same criteria for derecognition as for initial recognition?

The IPSASB confirmed Staff's view that the same criteria should be used for derecognition as for initial recognition.

SMC 19: Should Recognition Criteria be Included in Definition?

Should the recognition criteria be an integral part of the element definitions, or separate and distinct requirements?

The IPSASB confirmed Staff's view that the recognition criteria should not be integrated in element definitions.

THEME 6: RESIDUAL/EQUITY INTERESTS AND OWNERSHIP INTERESTS

1. This theme comprises two questions relating to (i) the relationship between residual/equity interests and revenue and expenses and (ii) the treatment of the concept of ownership interests. Both these questions will be discussed at the March 2012 meeting:

SMC 12(a): Relationship between Residual/Equity Interests and Revenues and Expenses

Should transactions with residual/equity interests be excluded from revenues and expenses?

SMC 15(b): Treatment of Ownership Interests in Definitions

Should the concept of ownership interests, such as those that relate to minority or non-controlling interests in a GBE, be incorporated in the element definition?

Appendix B: List of SMCs with Allocation of Themes

SMC	Theme	Meeting at which SMC was or will be dealt with		
		Sep 2011	Dec 2011	Mar 2012
1(a)	3			To do
1(b)	3	Done		
2(a)	3	Done		
2(b)	2			To do
2(c)	3	Done		
3	3		To do	
4	2		To do	
5(a)	3	Done		
5(b)	3	Done		
6(a)	3			To do
6(b)	3	Done		
7(a)	3	Done		
7(b)	2		To do	
7(c)	2		To do	
8	3		To do	
9(a)	2		To do	
9(b)	2		To do	
9(c)	2		To do	
10(a)	3	Done		
10(b)	3	Done		
11(a)	1		To do	
11(b)	1		To do	
12(a)	6			To do
12(b)	4		To do	
13(a)	1	Done		
13(b)	1		To do	
14(a)	1		To do	
14(b)	1		To do	
14(c)	1		To do	
15(a)	4		To do	
15(b)	6			To do
15(c)	4	Done		
16(a)	4		To do	
16(b)	4		To do	
17(a)	5	Done		
17(b)	5	Done		
18	5	Done		
19	5	Done		

Issues Paper

Conceptual Framework, Phase 2: Themes for Analysis of Responses to SMCs

THEME 1: DETERMINING APPLICABILITY TO THE PERIOD

Introduction

- 1.1 This theme considers the appropriate approach to reporting financial performance in the public sector. It has a pervasive influence over much of the discussion of elements. It considers:
- Approaches to recognizing revenues and expenses;
 - Stocks and flows; and
 - The GASB approach to reporting financial performance.

Approaches to Recognizing Revenues and Expenses

- 1.2 CF–CP2 identified two approaches to recognizing revenues and expenses in the statement of financial performance: the asset and liability-led (A&L-led) approach, and the revenue and expense-led (R&E-led) approach. The arguments for each approach were set out in paragraphs 4.1 to 4.39 of the Consultation Paper and are not repeated here. These approaches were the subject of an Education Session at the March meeting.
- 1.3 It is the view of both the TBG and Staff that counterposing the two approaches is not likely to be useful. It is important to identify and develop the attributes of both approaches that meet the objectives of financial reporting.
- 1.4 The IASB has adopted the asset and liability-led approach in its Framework and standard-setting activities. The TBG and Staff note that at a standards level the IASB has developed the mechanism of “Other Comprehensive Income” (OCI).¹ OCI has been used to present items of income and expense that IFRSs require or permit to be recognized outside profit and loss. Such items have included re-measurements and foreign currency translation adjustments. Subsequently certain of these items are permitted to be recycled to profit and loss on realization, while, for other items, no recycling is permitted.
- 1.5 There are no clear principles guiding decisions on whether at a standards-level an item should be permitted or required to be presented in OCI or whether an item should be recycled. Recently there has been considerable criticism of OCI for its lack of conceptual purity. This is important, because, while, for its advocates, the A&L-led approach avoids the subjectivity that they associate with the R&E-led approach, it is evident that, under the A&L-led approach key presentational issues have been devolved to the standards-level. Furthermore there has been little conceptual guidance on how flows that are appropriate for inclusion within profit and loss are to be distinguished from those that are to be accounted for outside profit and loss. In other words it is important to recognize that, although application of the A&L-led approach at its purest provides clarity on the

¹ IPSASB has not adopted the term “other comprehensive income” in IPSAS 1, *Presentation of Financial Statements*.

approach to revenue and expenses the and determination of applicability of flows to reporting periods, in practice the standard-setter has been faced with difficult decisions on how a particular flow should be presented at the standards-level. Such difficulties can be compounded by constituent pressures on specific financial reporting issues.

- 1.6 There are also cases where it is not immediately clear whether items meet the definitions of assets and liabilities. In such cases decisions have to be made on the treatment of such items. Examples of such items that have been identified by members of the TBG include (i) bond issuance costs, (ii) the excess of sales proceeds over carrying amount in sale and leaseback transactions resulting in a finance lease, and (iii) inflows of taxation resources received prior to a taxable event. In all these cases the approach of the Governmental Accounting Standards Board (GASB), the most prominent exponent of an R&E-led approach, would be to recognize a deferred inflow or deferred outflow.²
- 1.7 One of the characteristics of the public sector that distinguishes it from the for-profit private sector is that, in the public sector, inflows are often received or outflows made in advance of the periods in which related programs are to be carried out. For example, at the end of fiscal year 20X1 a national government provides a provincial government with an unconditional block grant to fund programs to be carried out in fiscal year 20X2; if the province recognized the entire grant as revenue in 20X1, with all the program expenses, financed by the grant, recognized in 20X2, the reported results under an A&L-led approach might give a misleading picture of the financial position of both governments.³ It seems dubious whether a reporting approach that fails to provide information on the period for which the block grant is to finance outlays will meet the objectives of accountability and decision-making. Some might argue that an entity that has received resources, which it only needs to wait for time to pass to use in carrying out its programs, is better off than an entity that still has to procure that funding. The solution to providing the information about the status of the grant might be considered to be an issue over “how” the item is presented, rather than questioning whether “what” new element is required to depict the position of the entity.
- 1.8 There are further related considerations. These include that (i) in the public sector there is considerable emphasis on the annual nature of programs and results, and (ii) a focus on inter-period equity (explained below).
- 1.9 There is thus an “information need” on the part of users for attributing certain revenues and expenses to particular reporting periods and, therefore in Staff’s view, “information value” in such attribution.
- 1.10 The challenge is how this information need is to be satisfied. Possible options include (i) deferring the revenues or expenses to the appropriate period either by the creation of additional elements or through presentational mechanisms or (ii) note disclosure of the amounts of the flows that relate to other reporting periods and an explanation of the methods for estimating these amounts.

² The GASB approach is explored further in a later section of this theme.

³ This analysis assumes that the funding and outlays are material to both entities’ financial positions.

Stocks and Flows

- 1.11 In seeking a different way forward to that of counterposing the two approaches, the TGB discussed the objectives of financial reporting to meet user needs. If it is accepted that financial statements must reflect economic substance for user needs to be met, then the financial statements must report on matters of economic substance: that is a set of economic stocks and flows. Such stocks could be defined as resources and claims, rights or obligations, and/or deferrals within the financial statements, or, for “more comprehensive” financial reports, could be defined to include such things as policy (including both tax and social) commitments, and intangible stocks such as human resource capacity and reputation.
- 1.12 In the case of deferred expenses, the entity has generally met an obligation which is expected to occur in the future, but is not present at the reporting date. In the case of deferred income the entity has received income which is expected to be receivable in the future, but was not a receivable right in the reporting period.⁴
- 1.13 The crux of the question to be resolved is “What is the economic substance of such items?”
- 1.14 Two views are possible.
- A flow has occurred, but that flow has not impacted the financial position of the entity in terms of making it better off or worse off. The statement of financial position should therefore ensure such items do not impact its net assets/liabilities (equity) position. If the flows do not create items that are “present” at the reporting date in the manner required by the (likely) asset and liability definitions, then new elements must be added to reflect the economic substance of the unchanged financial position;
 - A flow has occurred and that flow has impacted on the financial position of the entity in terms of making it better or worse off. The statement of financial position should therefore allow such items to impact its net assets/liabilities (equity) position. The nature of the flows, however, is that the flexibility of the future operations of the entity is affected. For example, in the case of deferred revenue, the asset received can only be used in a certain manner, or in the case of deferred expenses, the entity’s ability to affect future expenses has been curtailed. Such limited flexibility is important information for accountability and decision-making purposes and should be made clear in the financial statements – this could occur either through (i) classifications within net assets/liabilities (equity) or (ii) separate note disclosure.
- 1.15 In summary, is the substance of the deferred item to impact on the amount of the net financial position of the entity, or does it impact the nature of the net financial position of the entity?

⁴ It has been axiomatic throughout the IPSASB’s Conceptual Framework project that disclosure of an item that meets the definition and recognition criteria of an element does not meet the objectives of financial reporting.

The GASB Approach to Reporting Financial Performance

- 1.16 Having ascertained that the attribution of certain revenues and expenses to particular reporting periods does have information value it is worth considering how such an approach has been applied. The only standard setter that has adopted an approach explicitly based on the attribution of flows to reporting periods is GASB. GASB has argued that the measurement focus of the resource flows statement is critical to determining the nature and period to which an outflow or inflow of resources is applicable. The foci that GASB has identified include:
- a. Economic resources measurement focus – the period to which an outflow (or inflow) of resources is applicable is determined using the concept of *interperiod equity*; and
 - b. Cash measurement focus – the period to which an outflow (or inflow) of resources is applicable is the period in which cash is disbursed (or received).
- 1.17 As indicated, the first of these options is based on the concept of interperiod equity. Interperiod equity is achieved when the current period inflows of resources equal the current period costs of services. Under a position of equilibrium where interperiod equity is achieved, the cost of services is borne by current year taxpayers and other resource providers, rather than (i) being shifted to future-year taxpayers or resource providers through an increase in the level of borrowing or the carrying forward of a deficit, or (ii) the use of accumulated surpluses to provide current period services. Potentially there is also a disequilibrium where current resource providers finance goods and services to be provided in future years. Interperiod equity is used to assess accountability, rather than being a goal that is expected to be met for any particular period of time. (See GASB Concepts Statement No. 4, *Elements of Financial Statements*.)
- 1.18 Interperiod equity requires that if the related service is being provided in the current period, an inflow should be treated as current period revenue; if the related service is being provided in a later period, an inflow should be treated as deferred revenue.
- 1.19 The GASB has recently responded to a need for guidance in applying the economic resources measurement focus. The types of transactions that GASB has considered include:
- Outflows of resources that do not meet the definition of an asset and are inherently related to services that the government will provide in future periods;
 - Inflows of resources that do not meet the definition of a liability and can only be used in the future; and
 - Inflows of resources related to items that were not previously recognized as assets in the financial statements (future resources).⁵
- 1.20 For clarity, it should be stressed that the GASB decision hierarchy is as follows:

⁵ GASB, *Preliminary Views on Concepts Related to Recognition of Elements on Financial Statements and Measurement Approaches*, paragraph 10, issued June 2011.

- a. Does the item meet the definition of an asset or a liability? If yes, treat it as such.
 - b. If the item does not meet the definition of an assets or a liability, assess the deferral treatment.
- 1.21 In August 2011 the GASB issued an Exposure Draft, *Reporting Items Previously Recognized as Assets and Liabilities*, to amend the financial reporting element classification of certain items previously reported as assets and liabilities to be consistent with the definitions in Concepts Statement No. 4.

Staff Views on SMCs

SMC 11(a) and (b): Approach to Determining Revenues and Expenses

Staff View:

Staff acknowledges strongly that the attribution of certain flows to particular reporting periods has “information value.” Staff has reservations whether the attribution of flows to applicable periods can be done in a sufficiently objective way to justify wholesale adoption of the R&E-led approach. While there are many examples in which attribution of flows to particular reporting periods appears straightforward, such as the example of the block grant above, there are other instances where such attribution is more questionable. For example, should redundancy costs incurred as a result of a modernization program to reconfigure service delivery be deferred over future reporting periods which are to benefit from that reconfiguration? Nevertheless Staff is convinced that aspects of the R&E-led approach need to be incorporated in IPSASB’s standard-setting, in particular in considering appropriate note disclosures.

SMC 14(a), (b) and (c): Need to Identify Deferrals on the Statement of Financial Position?

Staff View:

- (a) Staff acknowledges the view that there is a need to identify deferrals either on the face of the statement of financial position or in the notes to the financial statements. On balance, Staff does not support the identification of deferrals on the face of the statement of financial position and thinks that, for example, information on current period inflows of resources that are to be used to finance services in future reporting periods should be provided through note disclosure.
- (b) While Staff does not support the identification of deferrals on the face of the statement of financial position, if it were to be decided to include deferrals, Staff considers that deferred outflows and deferred inflows should be defined as separate elements.
- (c) If definitions were to be required, the definitions of a deferred outflow and a deferred inflow in paragraph 5.8 of CF–CP2 are appropriate and complete.

SMC 13(b): Additional Characteristics/Issues re: Revenues and Expenses

Staff View:

There are no further additional characteristics/issues that need to be considered in determining the definitions of revenues and expenses.

Action Requested:

Members are asked to **confirm** the staff views or **provide** alternative directions.

Appendix A: Theme 1—Material Presented at September 2011 Meeting for Applicable SMCs

This material is reproduced from Agenda Item 4C.0 for the September 2011 meeting.

Approach to determining revenues and expenses (SMC 11) [Paragraphs 15–24]

15. SMC 11(a) asked:

Should revenues and expenses be determined by identifying which inflows and outflows are “applicable to” the current period (derived from a revenue and expense-led approach), or by changes in net assets, defined as resources and obligations, “during” the current period (derived from an asset and liability-led approach)?

16. Of the respondents who commented on the SMC, a small majority (53%) supported the asset and liability-led approach. However, it is clear that the respondents have widely-varying views of the impact of the two approaches: one stated that in most circumstances the two approaches should yield identical results (Respondent 24), another stated that the Conceptual Framework should be aligned with both approaches (Respondent 35), and a third stated that one approach is applicable to budget performance and the other to equity performance (Respondent 3). Two respondents questioned the accuracy of the examples in the CP (Respondent 24 and Respondent 28), one noting that both examples focus on the reporting of revenue, but do not illustrate differences in the reporting of expenses. (Further comments on the examples are reported in paragraphs 22 and 23 below).

17. In addition to the comments made in responding to SMC 11(a), several respondents indicated the importance that they attach to this issue by referring to it in the introductions to their response letters (Respondents 2, 5, 14, 21 and 25). Respondent 25 thought that if the revenue and expense-led approach “were articulated more clearly, it may be feasible to identify the conceptual difference between the approaches and reduce the risk of disagreements based on misunderstandings.”

18. Some also commented on this matter in responding to SMC 13(b). For example, “...in our view, which is shared by most other senior Canadian governments, the revenue and expense led approach best supports the balanced budget framework under which Canadian governments operate” (Respondent 5).

19. SMC 11(b) asked:

What arguments do you consider most important in coming to your decision on the preferred approach?

20. Among the arguments raised in support of the revenue and expense-led approach were (a) that it results in a more accurate measure of the inflows and outflows of the entity during the period, and, reflecting the view of Respondent 5 above, (b) that it provides a clearer alignment with the budgetary frameworks under which most public sector entities operate. Proponents believe that it facilitates inter-period equity, and fully reflects the annual cycle of financial reporting. Many of the respondents supporting this approach are financial statement preparers.

21. Those supporting the asset and liability-led approach maintain that it permits more robust definitions of elements, and avoids both (a) the subjectivity of determining the applicability of revenues and expenses to particular periods, and (b) having to recognize

- deferred inflows and deferred outflows. Proponents consider that, in contrast to the revenue and expense-led approach, it properly represents economic phenomena, e.g., Respondent 30. Also, it is in harmony with the existing IASB Framework – although supporters of the revenue and expense-led approach counter that differences between the private and public sectors militate against a common conceptual framework.
22. One of the respondents to this question (Respondent 30) expressed the view that more detailed and comprehensive examples should be provided, to illustrate transactions such as valuation changes, losses/write-offs, and changes to the expected amount and timing of transactions. This observation supports the comments made in paragraph 16 on possible shortcomings or limitations in the examples.
23. There was also a detailed comment in SMC 13(b) on the examples. This included: “The second example was focused solely on the recognition of tax collections without occurrence of any related expense(s). There was no illustration of a reporting entity dealing with non-capitalizable expenses incurred during the period under an asset and liability-led approach as compared to a revenue and expense-led approach” (Respondent 19).
24. In the view of Staff, the fundamental significance of this issue and the range of respondents’ views necessitate further discussion at the December meeting.

Need to identify deferrals on the statement of financial position? (SMC 14) [Paragraphs 90–99]

90. SMC 14(a) asked:
Do deferrals need to be identified on the statement of financial position in some way?
91. Over half the respondents (52%) providing comments favored identifying deferrals on the statement of financial position, while over one-third (39%) did not. Not surprisingly, many of those opposing the identification of deferrals expressed – in SMC 11(a) – support of the determination of revenues and expenses by the asset and liability-led approach.
92. Because this issue is closely related to SMC 11(a), Staff believes that the two issues should be resolved at the same time. Since Staff sees the need to discuss SMC 11(a) at the December meeting, it follows that this issue will have to be carried forward too.
93. SMC 14(b) asked:
If yes, which approach do you consider the most appropriate? Deferred outflows and deferred inflows should be:
- (i) *Defined as separate elements;*
 - (ii) *Included as sub-components of assets and liabilities; or*
 - (iii) *Included as sub-components of net assets/net liabilities.*
94. This issue was not applicable to many respondents since they had indicated in SMC 14(a) that they did not support the identification of deferrals. Of those responding to SMC 14(b), about two-thirds favored defining deferred inflows/outflows as separate elements, with most of the rest wanting to include them as sub-components of assets and liabilities.

95. Among those favoring approach (i) – defining deferred inflows/outflows as separate elements, Respondent 29 stated that it supports the establishment of an element to recognize deferred revenue where appropriate and does not support attempts to require deferred revenue to meet a narrow definition of a liability in order to be recognized. Those favoring approach (ii) included one who believes that including deferred outflows and deferred inflows as sub-components of assets and liabilities reflects the true nature of these outflows and inflows, reduces the number of key elements making up the financial statements, and make it easier for statement users to understand (Respondent 4).
96. As with SMC 14(a), Staff believes that the discussion of this issue will have to be concluded at the same time as SMC 11(a), i.e., at the December meeting.
97. SMC 14(c) asked:
If defined as separate elements, are the definitions of a deferred outflow and deferred inflow as set out in paragraph 5.8 appropriate and complete?
[The two definitions in paragraph 5.8 of CF–CP2 are:
(a) Deferred outflow (of resources): an entity’s consumption or reduction of new assets that is applicable to a future reporting period.
(b) Deferred inflow (of resources): an entity’s increase or acquisition of net assets that is applicable to a future reporting period.]
98. A relatively small number of respondents commented in this issue, as it was only relevant for those that had indicated that deferred outflows should be separate elements in SMC 14(c). Just over half of these respondents considered the definitions to be appropriate and complete, while the others did not. Among the latter, one stated that the definition of deferred outflow “begs the question as to whether capitalized restoration costs concomitantly qualify as both assets and deferrals” (Respondent 30).
99. Again, Staff believes that the discussion of this issue will have to be concluded at the same time as SMC 11(a), i.e., at the December meeting.

Additional characteristics/issues re revenues and expenses (SMC 13) [SMC 13(b) only, paragraphs 127–129]

127. SMC 13(b) asked:
Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the definitions of revenues and expenses?
128. Nine respondents identified other issues. These included:
- The importance of determining the triggering event for the recognition of intervention expenses or taxation revenue. (Respondent 14)
 - Recognition of revenues and expenses related to such matters as natural resources and guarantees (such as pensions) are not suitable for general purpose financial reporting. (Respondent 16)
 - Issues of sustainability. (Respondent 16)
 - Linkages with the Key Characteristics ED. (Respondent 23)

- Where governments manage risk effectively, strategies must be disclosed and the results of the strategies recognized. (Respondent 34)
129. In the view of Staff, none of the foregoing issues need to be considered in determining the definitions of revenues and expenses. However, as with SMC 13(a), further discussion of the definitions should take place at the same time that SMC 11(a) is resolved, i.e., probably in December.

THEME 2: DUTIES, RESPONSIBILITIES, POWERS AND RIGHTS

Introduction

- 2.1 This theme examines a number of issues that are key to the definitions of liabilities and assets in the public sector including:
- a. What is “realistic” in a public sector context, where applying the notion of a constructive obligation and ascertaining when such obligations arise in the context of non-exchange transactions is difficult?
 - b. Whether certain rights and powers in the public sector, such as the right to levy taxes and fees, are inherent assets, or whether they are assets only when converted into powers and those powers are exercised (or is there an intermediate event)?
 - c. Whether a sovereign power gives a government the ability to repudiate obligations that would otherwise meet the definition of a liability?

Meaning of “Enforceability” and “a Realistic Alternative to Avoiding an Obligation”

- 2.2 CF–CP2 included two sections on the related issues of “enforceability” and “a realistic alternative to avoiding an obligation” in the context of a definition of a liability.

Enforceability on the Entity

- 2.3 The first section is “Enforceability on the entity” – paragraphs 3.28 to 3.36. This section outlines three approaches to identifying transactions and other events that would meet the characteristic of the absence of a realistic alternative to avoid the obligation; these three approaches are the subject of SMC 7(c). The wording of these paragraphs was considered by some respondents to be opaque. In particular, the discussion of “constructive obligations” in all three approaches was, in Staff’s view, confusing. Staff subsequently summarized these approaches for a public benefit committee of the UK Accounting Standards Board in the following manner, which may be clearer:
- a. The **first approach** in CF–CP2 (paragraphs 3.29–3.32) puts forward a view that all obligations, whether of an exchange or non-exchange character, must be enforceable in order to give rise to liabilities. Such an approach is narrow and its adoption would preclude the recognition of liabilities from constructive obligations, except in the restricted circumstances where a constructive obligation is legally enforceable (an example being, in countries with Anglo-Saxon legal systems, if a party changes his or her position substantially, either by acting or forbearing from acting in reliance upon a gratuitous promise, then that party can enforce the promise although the essential elements of a contract are not present). Practically, this approach would, if applied at a standards-level, lead to the non-recognition of a number of obligations that are not enforceable at the reporting date, including, arguably, obligations for environmental remediation. Adoption of this approach may also affect accounting for employee pension obligations.
 - b. The **second approach** (paragraphs 3.33–3.34) argues that, in addition to legally enforceable obligations, certain non-legally enforceable constructive obligations also

may give rise to liabilities. This approach argues that a non-legally enforceable obligation can only give rise to a liability for an exchange transaction. In paragraph 3.34, CF-CP2 discusses a view that obligations related to exchange transactions and non-exchange transactions should be dealt with differently, because “an entity has significant discretion in administering transactions that are not legally enforceable” in the case of non-exchange transactions. At a standards-level, application of such an approach might resolve many of the difficulties in the determination of when obligations give rise to liabilities for governmental programs to provide social benefits to citizens. This is because the notion of a constructive obligation has been particularly difficult to operationalize at standards-level with diverse arguments put forward as to when an obligating event, giving rise to a present obligation, occurs. As an example of how this approach would operate, a government’s liability for a state pension would probably be limited to unsettled installments at the reporting date, where a recipient has a legal right to receive payment. Such liabilities would arguably not extend to an actuarial assessment of the total outflow once an individual has reached retirement age and satisfied any other eligibility criteria, because an individual would not have a legal right to the total outflow at the reporting date. Many proponents of this approach consider that information on future flows related to current policy at the reporting date is essential to the satisfaction of user needs. However, they consider that such information should be provided in “more comprehensive scope” GPFRs dealing with the long-term sustainability of an entity’s finances and not in the financial statements;

- c. The **third approach** (paragraph 3.35) does not draw such a distinction between obligations related to exchange transactions and obligations related to non-exchange transactions. It argues that non-legally enforceable constructive obligations can give rise to liabilities for both exchange and non-exchange transactions. This approach is basically the current position in the IPSASB literature.

- 2.4 Among the respondents to SMC 7(c), there was some support for each of the three approaches. However, it is possible that because of the opaqueness of paragraphs 3.28 to 3.36 referred to above, the approaches were interpreted differently by different respondents. Confusion may also have resulted from the fact that enforceability was addressed in two places in CF-CP2 (see below).

Obligations Only When they Lead to Enforceable Claims

- 2.5 The second section dealing with enforceability CF-CP2 is entitled “Obligations only when they lead to Enforceable Claims” – paragraphs 3.50 to 3.58. SMC 9(a) asked whether the obligation of public sector entities, such as those associated with duties and responsibilities, are (a) perpetual obligations, (b) obligations only where there are enforceable claims, or (c) whether there is an appropriate intermediate event that is more appropriate. The collation of responses prepared for the September meeting showed that while about half the respondents supported either (a) or (b), very few of the other respondents considered that an intermediate event gave rise to obligations. The comment of one respondent indicated uncertainty about what “enforceability” entails, suggesting that moral obligations are enforceable. In drafting CF-CP2 Staff and TBG did not

envisage that moral obligations are enforceable. They therefore support those respondents that consider that enforceability must be assessed by reference to an external party.

Meaning of “Realistic”

- 2.6 As indicated above, SMC 7(b) asked whether a “realistic alternative to avoid the obligation” is an essential characteristic of a liability. This wording is currently reflected in the definition of an “obligating event” in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* and has been drawn from equivalent provisions in IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. Most respondents supported the view that a “realistic alternative to avoid the obligation” is an essential characteristic of a liability, although some expressed uncertainty about what “realistic” means in this context and suggested that the term needs to be defined.
- 2.7 Unless the view is adopted that sovereign power gives government the right to repudiate obligations which would otherwise meet the definition of a liability (see below for an analysis of this issue), few would contest that where an obligation is enforceable by legal or equivalent means the obligated entity does not have “a realistic alternative to avoid the obligation.” Evaluating whether an entity has a realistic alternative to avoid an obligation, where that obligation is not enforceable by legal or equivalent means is more problematic.
- 2.8 Interpretation of “realistic” has been a particular challenge in the public sector, where the issues are arguably more complex than in the private sector. In the private sector avoiding an obligation is usually evaluated in a commercial context – the risk of damage to reputation if an obligation is not met – with a consequent impact on future cash flows. Reputational risk certainly exists in the public sector and arguably, in an exchange context, differs little from the private sector. However, reputational risk related to non-exchange transactions in the public sector is more likely to be linked to ephemeral factors such as electoral position.
- 2.9 At a standards-level the realism of an alternative to avoid an obligation is normally linked to an entity’s communicating publicly that it will accept certain responsibilities and, by so doing, creating a valid expectation on the part of external parties that such responsibilities will be discharged. In a non-exchange context such expectations may be volatile. For example, the expectation of receipt of a state pension may vary between age cohorts, with cohorts close to retirement age holding stronger expectations of a state retirement pension than cohorts newly entering the workforce.
- 2.10 It is certainly questionable whether, in a non-exchange context, liabilities arising from obligations that are not enforceable meet the qualitative characteristic of comparability. This is because similar obligations may be accounted for differently between entities and between accounting periods within the same entity.

Exchange vs. Non-exchange Transactions

- 2.11 In order to adopt a conceptual approach that distinguishes between exchange and non-exchange transactions that distinction must be operable. The current definition of exchange transactions is:

Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

- 2.12 The current definition of non-exchange transactions is a residual:

Transactions that are not exchange transactions. In a non-exchange transaction an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

- 2.13 It must be conceded that, in practice, the distinction between exchange and non-exchange transactions is sometimes not clear-cut⁶ and that, furthermore, some respondents (e.g., Respondent 25) do not favor accounting approaches based on such a dichotomy. Such respondents advocate that, for example, the IPSASB develop composite requirements for revenue that are not based on whether a transaction is exchange or non-exchange in character.

- 2.14 An example of where ambiguity might arise is government-supplied medical benefits. Such benefits will usually be provided in non-exchange transactions, but where those benefits are for a military veteran with respect to injuries sustained in combat, such medical provision could be construed as an exchange transaction. It can also be unclear whether redundancy costs are exchange or non-exchange transactions. Such ambiguities may be the reason why some respondents to CF–CP2 were skeptical about the distinction between exchange and non-exchange transactions, expressing views that it would not work in practice. Staff considers that the determination of whether a particular transaction is an exchange or non-exchange transaction may not be straightforward and that professional judgment will need to be exercised, but that this should not negate the drawing of a distinction between exchange and non-exchange transactions in the approach to “enforceability.”

Sovereign Power to Avoid Obligations

- 2.15 It has been suggested that sovereign power provides national governments with an ability to “walk away” from many obligations. This is based on the assumption that a government’s ability to enact, amend or withdraw legislation enables it to renege on its obligations, including legal obligations.
- 2.16 CF–CP2 put forward a converse view, in paragraphs 3.59 and 3.60, that this power is usually constrained by economic, social or political consequences. As a result, CF–CP2 suggested that it is not reasonable to exclude a government’s obligations as liabilities, simply on the basis of sovereign power. Furthermore, such an approach would be inimical to the objective of accountability and would lead to an unfaithful representation

⁶ An example of where this ambiguity surfaced in recent IPSASB deliberations was the discussion of governmental interventions in the automobile industry during the global financial crisis in the context of entity combinations. The IPSASB found it difficult to conclude whether such interventions were exchange or non-exchange in character and therefore found it difficult to develop accounting treatments based on an exchange/non-exchange distinction.

of a government's financial position. Taken to an extreme, but logical conclusion, the argument that sovereign power allows government to repudiate obligations could be used to justify virtually all obligations not meeting the definition of a liability, regardless of whether such obligations arise from exchange or non-exchange transactions.

- 2.17 In the view of Staff the most appropriate approach to evaluating whether an obligation gives rise to a liability is by referring to the legal position at the reporting date. An approach that is not based on this principle will lead to the presentation of financial information that, in particular, does not meet the qualitative characteristics of faithful representation and relevance.

Governmental Powers, Rights and Responsibilities

- 2.18 Paragraphs 2.49–2.57 of CF–CP2 considered unique public sector powers and rights. Such powers include, principally, the power to tax, but also the power to issue licenses or to regulate access to benefits embodied in intangible resources. CF–CP2 gave the example of the electromagnetic spectrum as an example of the latter. CF–CP2 also noted that some consider that the power to tax differs from rights related to intangible assets, because the former is inherent in government, while the latter requires the creation of a right to regulate access.
- 2.19 Staff and the TBG consider that this issue might be better understood if governmental powers and responsibilities are considered as a three stage process. Using taxation as an example, a government may be considered to (i) have a general right to tax. Legislation is then required to be enacted in order to convert such a general right into (ii) a power to tax. Taxes are then (iii) levied under the provisions of this legislation. The levying of a tax is often triggered by an underlying transaction, such a sale for a sales tax; in the case of taxes on property, the trigger is ownership of the property for a relevant period or at a particular date.
- 2.20 The key issue is (i) whether such rights are assets; or (ii) whether powers are assets; or (iii) whether such rights and powers only give rise to assets when powers are exercised i.e., in the above example when taxes are levied. Those who consider that such rights or powers are assets consider that the exercising of those rights and powers is a recognition issue. For example, both the right and the power to tax are present resources and therefore assets, but those assets will not be recognized until a further event, such as the levying of a tax assessment takes place. Until that further event takes place the assets cannot be measured reliably and therefore would not be recognized.
- 2.21 Others take the view that rights and powers are “means to be drawn on” for accessing resources and that an asset only arises when rights are converted into powers and those powers are exercised.
- 2.22 Staff is not convinced that a general right to tax is an asset, because it is too general and remote a phenomenon. Staff considers that the view that the power to tax is an asset has more merit, but again inclines to a view that it is too general until such powers are exercised.
- 2.23 The obverse of governmental powers and rights are governmental responsibilities to provide services such as security, education and health. Staff considers that (i)

governments have a general responsibility to provide a minimum level of services and ensuring a safe and secure environment. That general responsibility becomes an obligation (but not a present obligation) when legislation is enacted. Staff considers that such obligations are analogous to stand-ready obligations and do not give rise to present obligations until there are enforceable claims by third parties. It should be noted that some TBG members are skeptical about the analogy to a stand-ready obligation.

- 2.24 Staff also considers that the two issues are interconnected and that it is asymmetrical to adopt a view that the power to tax is an asset while not simultaneously considering that general governmental responsibilities give rise to liabilities.

Staff Views on SMCs

SMC 7(b): Absence of Realistic Alternative to Avoid Obligation Needed to Define Liability?

Staff View:

Staff considers that a distinction should be drawn between exchange and non-exchange transactions and that only enforceable obligations arising from non-exchange transactions give rise to liabilities.

SMC 7(c): Approach to Determining Realistic Alternative to Avoid Obligation?

Staff View:

Staff considers that the notion of a “realistic alternative to avoid an obligation” is operable in an exchange context. Staff has strong reservations whether it is feasible to define a realistic alternative to avoid an obligation in a non-exchange context.

SMC 9(a): Public Sector Obligations Arise only from Enforceable Claims?

Staff View:

Public sector responsibilities and obligations give rise to liabilities only when there are claims that are enforceable by external parties.

SMC 9(b): Enforceability Essential Characteristic of Liability?

Staff View:

Enforceability by an external party is an essential characteristic of an obligation that gives rise to a liability for a non-exchange transaction. A liability may arise from constructive and other obligations which the entity cannot avoid related to exchange transactions.

SMC 9(c): Definition of Liability includes Assumption about Sovereign Power?

Staff View:

In determining whether a liability exists, reference should be made to the legal position at the reporting date, but this does not need to be explicitly stated in the definition of a liability.

SMC 4: Public Sector Rights/Powers Inherent Assets?

Staff View:

Governmental (public sector) rights and powers give rise to assets only when the relevant powers are exercised.

Action Requested:

Members are asked to **confirm** the staff views or **provide** alternative directions.

Appendix B: Theme 2—Material Presented at September 2011 Meeting for Applicable SMCs

This material is reproduced from Agenda Item 4C.0 for the September 2011 meeting.

SMC 7: Absence of a realistic alternative to avoid the obligation as an essential characteristic and approach to determining whether an entity has a realistic alternative to avoid an obligation [SMC 7(b) and (c) only, paragraphs 56–63]

56. SMC 7(b) asked:

Do you agree that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability?

57. A very large majority (85%) agreed with this statement. The two negative views were that the ability to avoid an obligation should be treated as a possible recognition criterion (Respondent 25), and that this could lead to the recognition of liabilities for which the legal obligation is not established (Respondent 27).

58. Staff cautions that the response should be interpreted carefully, as it seems questionable whether there is a consensus on what a realistic alternative to avoiding an obligation entails. In this context, Respondent 30 notes that the concept of unavailability should be considered in conjunction with the obligating event being outside the control of the entity, and recommends that further guidance should be included in the ED as to the definition of “realistic”. The response therefore needs to be considered with the response to SMC 7(c).

59. The foregoing leads the Staff to the view that discussion of this issue will need to be continued at the December meeting.

60. SMC 7(c) asked:

Which of the three approaches identified in paragraph 3.28 do you support in determining whether an entity has or has not a realistic alternative to avoid the obligation?

[The three approaches identified in paragraph 3.28 of the CP are:

- (a) Enforceable contractual, constructive, and equitable obligations.
- (b) Enforceable contractual, constructive, and equitable obligations and other constructive and equitable obligations associated with exchange transactions.
- (c) Enforceable contractual, constructive, and equitable obligations and all other constructive and equitable obligations from which the public sector entity cannot realistically withdraw.]

61. A small number of respondents (21%) favored an approach that is limited to enforceable obligations, i.e. approach (a). One of these stated “in the under developed regions having fragile political systems, the only realistic approach is (a)” (Respondent 9). The same number (21%) favored (b); with one commenting “This approach encompasses constructive and equitable obligations associated with exchange transactions where there is no legal basis for enforceability, but where there is no reasonable alternative to avoid the obligation” (Respondent 20).

62. A larger group (41%) favored (c). A comment from a respondent in this group was:
“Unlike commercial enterprises, public sector entities are often subject to strong social expectations (e.g. through policy and program announcements) that often leave the Government with no real alternative. Therefore, ACAG believes liabilities should not be limited to legal obligations, but should extend to enforceable contractual, constructive, equitable obligations and all other constructive and equitable obligations for which the entity cannot realistically withdraw” (Respondent 1).
- 62A. Staff notes that this comment implies that program announcements themselves, as opposed to legislation, give rise to obligations. In the view of staff this would lead to the recognition of a large number of commitments as liabilities.
63. Staff is of the view that discussion of this issue will need to be continued at the December meeting.

[Whether public sector entity obligations arise only from enforceable claims \(SMC 9\)](#)
[\[Paragraphs 68–81\]](#)

68. SMC 9(a) asked:
Recognition and measurement criteria aside, are public sector entity obligations such as those associated with its duties and responsibilities as a government, perpetual obligations, obligations only when they are enforceable claims, or is there an appropriate intermediate event that is more appropriate?
69. A few of the respondents (13%) saw public sector entity obligations as perpetual obligations. One respondent stated that it considered the inherent responsibilities of government to provide security, health, education and other services to its citizens result in the existence of perpetual obligations to transfer benefits to another party and that the government has no realistic alternative to avoid these obligations, and therefore they are a liability (Respondent 18). A larger number of respondents (37%) saw public sector entity obligations as obligations only where there are enforceable claims; one observed that a government’s responsibility should only be considered obligations when they lead to enforceable claims – the existence of a program/responsibility is not sufficient evidence of an obligation (Respondent 23).
70. However, half of the respondents (50%) had other views (which were not necessarily expressed in terms of “an appropriate intermediate event”). For example, one respondent stated that it considered obligations to provide social benefits to be liabilities that may qualify for recognition, but does not support depicting such obligations as “perpetual obligations” because they are continually settled and replaced with new obligations (Respondent 25).
71. In the view of Staff, the complexities of this issue mean that it will require further discussion at the December meeting.
72. SMC 9(b) asked:
Is the enforceability of an obligation an essential characteristic of a liability?

73. Over half of the respondents (52%) considered that enforceability is essential. A substantial minority (33%) disagreed. This does not appear to be fully consistent with the views expressed in SMC 7(c), where few respondents appeared to see enforceability as being essential in defining an obligation, and suggests that there is some uncertainty about what “enforceability” means.
74. This is illustrated by some of the comments from respondents. Respondent 13 supported the view that enforceability is an essential characteristic and wrote “Enforceability can arise from contractual, constructive political or moral obligations.” For this respondent a moral obligation is enforceable. One who disagreed explained “Enforceability of an obligation is not an essential characteristic of a liability, as obligations may also arise from moral or ethical consequences that cannot be legally enforced” (Respondent 5).
75. A few other respondents (15%) expressed different views, for example, one considered that if an entity wishes to recognize obligations beyond those that are enforceable, on the basis that it intends to comply with those obligations to carry out its mandate or for other justifiable reasons, it should be allowed but not required to do so (Respondent 19). This seems to imply too much discretion to preparers and would, in the Staff view undermine comparability.
76. Staff believes that with the complexity of this issue, and its relationship with SMC 9(a), it will not be practical for the Members to reach a decision at this meeting.
77. SMC 9(c) asked:
Should the definition of a liability include an assumption about the role that sovereign power plays, such as by reference to the legal position at the reporting date?
78. Framework–CP2 noted that some suggest that sovereign power enables a government to walk away from many of its obligations. Framework–CP2 put forward a view that any discussion supporting the definition of a liability should specify what underlying assumption is made about the specific power of government and suggested that one approach might be to base the determination of whether a liability exists by reference to the legal position at the reporting date, rather than a strict application of sovereign power. Over half of the respondents expressing a clear view on this issue (and 43% of those providing comments) considered that the liability definition should include an assumption about sovereign power, while just under half (32% of those providing comments) said that it need not.
79. One respondent in the first group stated that “the definition of a liability must reflect the role that sovereign power plays with respect to government obligations, in particular when it relates to non-exchange transactions, such as transfer payments or contributions to third parties that are dependent on annual legislative approval for continued funding” (Respondent 5). One respondent from the second group observed that it is necessary to assume that at the reporting date the government will meet all its liabilities that it is required to recognize under the relevant financial reporting framework and legislation in place at that time (Respondent 13).
80. Another view expressed was that this is a recognition issue, rather than one affecting the definition of a liability (Respondent 25).

81. Staff considers that the wording of the SMC may have suggested disagreement amongst respondents that does not exist. The large majority of respondents agreed that the existence of sovereign power should not be used as a rationale for the non-recognition of obligations that otherwise meet the definition of a liability and the recognition criteria. Staff believes that the determination of whether a liability exists should be by reference to the legal position at the reporting date, but that this might be addressed in supporting narrative rather than explicitly stated in the definition of a liability.

Whether public sector rights/powers are inherent assets (SMC 4) [Paragraphs 109–111]

109. SMC 4 asked:

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, are they assets only when those powers are exercised, or is there an intermediate event that is more appropriate?

110. Most respondents (over 75%) agreed with the statement that they are assets only when the powers are exercised. A typical comment was that the existence of a right in itself does not give rise to a claim to economic benefits or to service potential, but an event or action related to the exercise of this right gives rise to an asset (Respondent 31).
111. In the view of Staff, inherent assets of a public sector entity are assets only when the entity exercises its rights.

THEME 3: ASSET AND LIABILITY DEFINITIONS – PAST EVENTS AND OTHER ATTRIBUTES

Introduction

3.1 This theme considers whether the definition of an asset and a liability need to specify a past event or whether it is sufficient to state that an asset is a “present resource” and a liability is a “present obligation.” The theme also includes other aspects of the attributes of assets and liabilities, including the types of benefits that should be associated with an asset, the types of obligation that should be associated with a liability and other characteristics. At this meeting the focus is on “past events” with the other attributes to be discussed in March 2012.

Present Resource or Past Event?

3.2 Section 2 and Section 3 of CF–CP2 considered whether the definition of an asset and the definition of a liability need to specify that they result from a past transaction.

3.3 There are 3 options considered in this analysis. Both assets and liabilities are considered together:

- a. **Option 1:** Do not include the term “past event” in the definitions: it can be helpful to identify a past event, but this not an essential characteristic;
- b. **Option 2:** Include the term “past event” in the definitions; an inability to identify a past event, precludes a resource or obligation meeting the definition of an asset or liability; and
- c. **Option 3:** Do not include the term “past event” in the definition, but treat a past event as a recognition criterion.

3.4 Those who favor **Option 1** consider that:

- a. Some have placed undue emphasis on identifying the past event that gave rise to an asset or liability. This could be a distraction, and lead to debates about which event is the triggering event, instead of focusing on whether the asset or liability presently exists at the financial statement date;
- b. The failure to observe a past event does not negate that an asset or liability exists – it is not a fundamental characteristic of either element, and might lead to non-recognition of an asset or liability;
- c. There may have been unnecessary debates about what the past event was; and
- d. The phrase “as a result of past events” does not reflect that there may have been past transactions or events that resulted in assets or liabilities which no longer exist.

3.5 Some who do not favor the inclusion of a “past event” in the definition of an assets and a liability have suggested that “existing” be inserted before resource/obligation. When the IASB and the FASB were deliberating their Conceptual Framework in 2006, they

- concluded that this may exclude items such as prepaid rent because prepaid rent gives the entity the right to a future, not a present, use of the item rented.
- 3.6 It has been considered inappropriate to use the term “future” resource/obligation in the definition of an asset or liability, as it could introduce the possibility of recognizing future assets, such as tax revenues and future liabilities such as ongoing program commitments. According to this view, while a government may have an obligation to provide education or purchase a new fire truck in the future, until it provides that service or acquires that fire truck it does not have a present obligation and therefore a liability for them (see also Theme 2 for a discussion of public sector responsibilities and obligations).
- 3.7 Some of the discussion at the October 2008 meeting is relevant. At that meeting it was pointed out that the current IPSASB definitions of asset and liability do not parallel each other. For example, while the liability definition refers to a “present” obligation, the asset definition does not refer to a “present resource.” The inclusion of “past event” in the definition of an asset was arguably intended to clarify that a resource presently exists. Inserting “present” before resource in the asset definition would clarify that the resource must be available at the reporting date and make the inclusion of “past event” superfluous. Further, some consider that the inclusion of “past event” in the definition of a liability is redundant as the definition refers to a present obligation, meaning that at the financial statement date a third party has a claim on the resources of the entity. Inserting “present” before resource can accomplish the same thing and result in a symmetrical approach to the liabilities definition.
- 3.8 Those who favor **Option 2** consider that in the public sector, it may be more important to identify past events than in the private sector, because of the nature of governmental and public sector rights and powers and responsibilities and obligations that has been discussed in Theme 2. This is particularly the case if the view is adopted that such rights and powers are not inherent assets and that the duties and responsibilities of government are not perpetual obligations that meet the definition of a liability. If that view is adopted, the identification of a past event in the context of an asset is crucial in converting a “means to be drawn on” into a right to control resources and, similarly, an enforceable claim is crucial in converting a responsibility or obligation into a liability.
- 3.9 **Option 3** is a variant and refinement of the previous two options. This considers that the existence of a past event is not an integral characteristic of either an asset or a liability, but, rather, a recognition criterion. This view has been considered in more detail in the context of Theme 2.

Staff Views on SMCs

SMC 3: Past Event Necessary to Definition of an Asset? And SMC 8: Past Event Necessary to Definition of a Liability?

Staff View:

In September 2011, Staff agreed with those who argued that, for both assets and liabilities that, while identification of a past event is a highly useful indicator of the existence of a present resource or a present obligation, the identification of a past event

is not essential to the definition of either an asset or a liability and should not therefore be incorporated in the definitions. On balance, however, Staff takes the view that the unique nature of public sector rights and powers and responsibilities and obligations, which have no equivalent in the private sector, necessitates the identification of past events as essential characteristics of assets and liabilities. This view is consistent with the approach taken in Theme 2, where the Staff view is that unique public sector rights and powers and the inherent responsibilities of governments do not give rise to assets and present obligations (liabilities) until such rights are converted into powers and those powers are exercised (in the case of assets) and such responsibilities translate into enforceable claims (in the case of present obligations/liabilities).

Action Requested:

Members are asked to **confirm** the staff views or **provide** alternative directions.

Appendix C: Theme 3—Material Presented at September 2011 Meeting for Applicable SMCs

This material is reproduced from Agenda Item 4C.0 for the September 2011 meeting.

Past event necessary to definition of an asset? (SMC 3) [Paragraphs 42–44]

42. SMC 3 asked:

Is it sufficient to state that an asset is a “present” resource, or must there be a past event that occurs?

43. A few respondents (19%) thought that it is sufficient to state that an asset is a present resource; more considered that a past event must occur. However, a significant number (41%) thought that, while not necessary, it would be helpful or desirable for there to have been a past event. Comments from this latter group included:

- The reference to a past event is helpful; for an asset to have come into existence, there must have been a past transaction or event (Respondent 2);
- The occurrence of a past event provides further evidence of the existence of a present resource (Respondent 4); and
- The occurrence of a past transaction or event may be crucial evidence that prompts an entity to evaluate whether it has a present resource resulting from that transaction or event (Respondent 23).

44. Staff agrees with the tenor of Respondent 4’s response that while identification of a past event is a highly useful indicator of the existence of a present resource, the identification of a past event is not essential to the definition of an asset.

Past event necessary to definition of a liability? (SMC 8) [Paragraphs 64–67]

64. SMC 8 asked:

Is it sufficient to state that a liability is a “present” obligation, or must there be a past event that occurs?

65. Nearly one third of the respondents (30%) considered that it was sufficient to state that a liability is a present obligation, one of these stated “a past event may indicate the existence of a present obligation, but it is not an essential component of the definition of a liability” (Respondent 21). A larger number (43%) thought that a past event is necessary, using reasoning such as “A past event must systematically be identified (or identifiable) for an obligation, and hence a liability to be recognized” (Respondent 27).

66. Several (24%) took an intermediate position: that a past event is helpful or desirable, but not necessary. One respondent reasoned “A past event may be useful as an indicator that a liability exists” (Respondent 18). Another noted that reference to a past event is helpful in distinguishing mere current expectations of future outflows from past transactions and events (Respondent 2).

67. Staff believes that while identification of a past event is a highly useful indicator of the existence of a present liability, the identification of a past event is not essential to the

definition of a liability. This also parallels the view of Staff with regard to a past event in relation to the existence of an asset (SMC 3).

THEME 4: CONCEPTS OF CAPITAL AND CAPITAL MAINTENANCE

Introduction

- 4.1 This theme considers whether (i) the definitions of revenues and expenses should be limited to ordinary activities, (ii) whether net asset/liabilities are residual amounts, residual interests or ownership interests and (iii) whether transactions with residual/equity interests should be defined.
- 4.2 At the September 2011 the Board directed staff to consider the above issue in the context of concepts of capital and capital maintenance. The analysis in this theme draws very heavily on the summary of concepts of capital and capital maintenance that Andrew Lennard presented to the Board as an Appendix in an intermediate draft of CF-CP3, which was considered at the April 2010 meeting in Toronto. Staff is grateful to Andrew for the comprehensive and succinct analysis.
- 4.3 Both Staff and some members of the TBG have some reservations whether considering the above issues in the context of concepts of capital and capital maintenance is helpful and whether this material should be incorporated into the Basis for Conclusions of the ED. There is a view that discussion of capital maintenance should be confined to Phase 3: Measurement and reservations about the meaning of the term “capital” in a public sector context, in particular due to the fact that public sector entities other than GBEs do not have shareholders.

Concepts of Capital and Capital Maintenance

- 4.4 In the private sector the capital of an entity is a concept of its wealth. The surplus or deficit of an entity in a period represents the difference between its capital at the beginning and end of a period. The significance of surplus or deficit therefore depends on the concept of capital. A change in net assets/net liabilities will be reflected in surplus or deficit to the extent that it represents a change in that capital.
- 4.5 Financial statements may reflect a concept of capital in a number of ways including:
 - Particular changes in reported net assets can be excluded from the surplus or deficit (and presented separately)⁷ on the grounds that they do not, under the chosen concept of capital, represent part of the surplus or deficit of the period.
 - Capital maintenance adjustments may be made in arriving at the surplus or deficit for the year. The cumulative amount of such adjustments is then reported separately from accumulated surplus or deficit.
- 4.6 Concepts of capital may be broadly described as being of two types: financial and physical concepts. Financial concepts of capital employ a money perspective. The concept may be “nominal” that is, the number of units of currency held. Alternatively, a “real terms” financial capital concept can be used, under which capital is defined in terms of constant purchasing power: to reflect this capital is adjusted by changes in a price index. A real terms financial concept is sometimes referred to as a proprietary concept,

⁷ The analysis of Theme 1 has noted that the IASB has developed the presentational mechanism of “Other Comprehensive Income” to deal with items that have an impact on equity outside profit and loss.

- reflecting the fact that (in the private sector) shareholders are interested in maintaining the purchasing power of their investment.
- 4.7 If a real terms concept of capital is used it is preferable to do so by means of specific capital adjustments rather than by restating the carrying amounts of assets by reference to a general index. This is because the price of the specific assets held by the entity may not have changed in accordance with the general index. If the assets are revalued to current prices, and gains and losses are then adjusted by reference to general price changes, the financial statements will show the extent to which gains and losses are “real.”
- 4.8 A physical concept of capital emphasizes an entity’s need to maintain its operating capacity. This concept is sometimes referred to as “the entity concept.” Operating capacity may be assessed either in terms of the volume or the value of the output of an entity’s assets: in the past a volume concept has attracted most support. Another issue that arises is the extent to which financial assets and liabilities are to be included in the concept of “operating capacity.”
- 4.9 An operating capacity concept is appropriate where an entity is engaged in the provision of services, and whose operating capacity is therefore easy to define. Use of this concept will assist in meeting the needs of users who wish to assess the extent to which the entity has maintained its ability to provide services in the future. However, even if operating capacity is maintained, the entity may not have sufficient resources to meet the future demand for its services.
- 4.10 Where an operating capacity concept is used, articulation of the financial statements is assisted if a current replacement cost measurement basis is used, because the operating result reflects the current cost of assets consumed in operations. However, not all changes in replacement cost are reported in arriving at the operating result on an operating capacity basis, as holding gains and losses are reported separately.
- 4.11 A financial concept of capital maintenance is appropriate for the reporting of certain types of activity where operating capacity is difficult to define or of doubtful relevance. One example is an entity that is engaged in a specific activity of limited duration (such as managing a sporting or cultural festival). Another is an entity that is engaged in activities that essentially consist of managing a store of value, such as a fund of financial instruments. One possibility in the latter case is to use a concept of capital based on the ability to earn a market rate of return: this can be implemented by stating assets and liabilities at market values, if it is assumed that such values reflect the market rate of return.
- 4.12 A key characteristic of most public sector entities is that one of their main objectives is to deliver goods and services rather than to generate profits. This characteristic suggests that a physical concept of capital and an operating capacity concept of capital maintenance are most relevant. However, this assumption does not hold for all public sector entities. For example, a real terms financial concept of capital and a financial concept of capital maintenance will be more relevant for entities such as employee pension plans and social security funds.
- 4.13 Therefore it may not be necessary or appropriate to choose a single concept of capital. For example, an entity might segment its activities. It could use an operating capacity

concept to report the results of its operating activities, and a financial capacity concept to report the results of other activities. It is also possible to report an operating result, based on an operating capacity capital maintenance concept, and, after the addition of holding gains, make an adjustment to show the result after maintaining real financial capital.

Limiting Definitions of Expenses and Revenue to Ordinary Activities

- 4.14 If a physical concept of capital and an operating capacity concept of capital maintenance are adopted, Staff acknowledges the view that the definitions of revenue and expenses should exclude flows that do not relate to what were described in CF–CP2 as ordinary revenue-generating or service delivery activities. This would involve developing definitions of expenses and revenues that do not include peripheral or incidental activities.
- 4.15 A number of standard setters have recognized the view that users need information on certain types of flows by (i) sub-classifying certain types of income or revenue and expenses as gains and losses⁸ and by (ii) indicating that certain capital maintenance adjustments should not be included in the income statement (or equivalent)⁹. The US Financial Accounting Standards Board in its Statement of Financial Accounting Concepts 6 (CON 6), Elements of Financial Statement, has defined revenues and gains separately and the Canadian Accounting Standards Board has adopted a similar approach. In CON 6, revenues are “inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity’s ongoing major or central operations.” Gains are “increases in equity (net assets) from peripheral or incidental transactions of an entity and from all other transactions and other events and circumstances affecting the entity except those that result from revenues or investments by owners.”
- 4.16 On balance Staff does not think that the definitions of revenues and expenses in the ED should be restricted to specific types of activities. This is because Staff do not think that inflows and outflows of resources from “ordinary activities” differ conceptually from other inflows and outflows. Staff agrees with those respondents who consider that this issue relates to presentation. In particular Staff finds the views of Respondent 21 persuasive: “We note that historically there has been confusion within financial reporting standards regarding the meaning of operating activities and ordinary activities. Although entities will always have an interest in providing users with information on the results of ongoing activities as opposed to one-off events, this is a presentation and disclosure issue and should not drive the definitions of elements.”

⁸ For example, the UK Accounting Standards Board’s Framework uses the broader terms “gains” and “losses” and states that they include “revenue and expenses”, while the Australian Accounting Standards Board (AASB), the former New Zealand Accounting Standards Review Board (NZ ASRB) and the South African Accounting Standards Board (SA ASB) all acknowledge that the definition of revenue encompasses both revenue and gains.

⁹ For example, the IASB, the AASB and the former NZ ARSB have all considered capital maintenance adjustments in their Frameworks.

Net Assets/Net Liabilities as Residual Amounts, Residual Interests or Ownership Interests

4.17 Section 5 of CF–CP2 discussed whether net assets/net liabilities are simply a residual amount, a residual interest or an ownership interest. Staff agrees with those respondents who argue that net assets/net liabilities is a residual amount. This residual amount might be considered to represent the resources available to finance future activities¹⁰ of an entity. Staff acknowledges the views of those who argue that use of the term residual interest reflects the expectations of resource providers and service recipients in the capability of an entity to resource itself and carry out activities. However, staff considers the term “residual interest” ambiguous, because it may suggest an entitlement to a distribution of resources. For a similar reason Staff does not think that use of the term “ownership interest” is appropriate and does not think that the skepticism about the suitability of this term that was suggested in CF–CP2 has been disproven. Staff considers that ownership interests are confined to the financial interests of third parties in GBEs and do not need to be defined.

Staff Views on SMCs

SMC 12(b): Limiting Definitions of Revenue and Expenses to Specific Types of Activities?

Staff View:

Staff does not support limiting the definitions of revenue and expense to specific types of activity. Staff considers that it may be appropriate to distinguish flows arising from ordinary activities from other flows, but that this is a presentation matter that should not have an impact on the definition of elements.

SMC 15(a): Net Assets/Net Liabilities and Ownership Interests

Staff View:

Staff considers that net assets/net liabilities is a residual amount rather than a residual interest or an ownership interest.

SMC 16(a) and (b): Transactions with Residual/Equity Interests

Staff View:

Consistent with the view on SMC 15(a) above Staff does not consider that transactions with residual/equity interests should be defined as separate elements.

¹⁰ Conversely, the resources that are needed to finance previous activities of an entity.

Action Requested:

Members are asked to **confirm** the staff views or **provide** alternative directions.

Appendix D: Theme 4—Material Presented at September 2011 Meeting for Applicable SMCs

This material is reproduced from Agenda Item 4C.0 for the September 2011 meeting.

Exclude transactions with residual/equity interests from revenues/expenses? (SMC 12) [SMC 12(b) only, paragraphs 86–89]

86. SMC 12(b) asked:

Should the definitions of revenue and expense be limited to specific types of activities associated with operations, however described?

87. About a fifth of respondents providing comments supported limiting the definitions to specific types of activities, but the others would not limit them. Two respondents who would limit them stated that under the revenue and expense-led approach they would be limited to activities associated with operations (Respondents 14 and 20). One who would not limit them thought that such classifications are issues of financial statement presentation, rather than of element definition (Respondent 15).
88. Two respondents proposed other approaches to this issue. Respondent 2 recommended that the terms “gains” and losses” be substituted for “revenues” and “expenses”. Respondent 30 recommended that the concept of “other comprehensive income” be introduced. Staff notes that the notion of “other comprehensive income” that was introduced by the IASB in IAS 1, *Presentation of Financial Statements* has not been considered by the IPSASB.
89. Staff believes that because of the relationship of this issue with the basic question of the revenue and expense-led approach vs. the asset and liability approach, this issue will have to be further considered at the December meeting.

Net assets/net liabilities and ownership interests (SMC 15) [SMC 15(a) only, paragraphs 130–133]

130. SMC 15(a) asked:

Do you consider net assets/net liabilities to be a residual amount, a residual interest, or an ownership interest?

131. Among the respondents who expressed a clear view on this issue, nearly half considered net assets/net liabilities to be a residual amount, a few considered it to be a residual interest, one an ownership interest, and several thought that it depended on the entity or the jurisdiction.
132. One of those that consider net assets/net liabilities to be a residual amount noted that there is little information content in this amount (Respondent 2). Among those that would classify it as a residual interest, one said that it reflects the resources available to finance or deliver future services or amounts of past services that need to be funded through future revenues, giving the example of endowments: these are not available to cover in-year expense, but as there is no expectation to pay them out, they are not liabilities (Respondent 5). As to differences between entities or jurisdictions, a respondent said that the status of the net assets/net liabilities balance could vary depending on the nature and sources of funding of the entity, its function, or its legal and constitutional status (Respondent 13).

133. In Staff's view this issue too is likely to depend on decisions made on SMC 11(a) and related issues. If so, it will need further discussion at the December meeting.

Transactions with residual/equity interests (SMC 16) [Paragraphs 141–147]

141. SMC 16(a) asked:

Should transactions with residual/equity interests be defined as separate elements?

142. A minority of respondents (27%) favored defining transactions with residual/equity interests as separate elements. One stated that because residual or equity interests should be distinguished from other elements, they should be identified as a separate element (Respondent 31).

143. Comments from others included:

- The objectives underlying this point need to be clarified, with particular reference to SMCs 12 and 15. (Respondents 14 and 26)
- Transactions with residual interest holders could be defined as separate elements, but this would depend on the wording of the definitions. (Respondent 25)

144. In Staff's view, the issue of transactions with residual/equity interests will be difficult to resolve until agreement has been reached on the other elements, which will not be until the December meeting.

145. SMC 16(b)

If defined as separate elements, what characteristics would you consider essential to their definition?

146. Constrained by responses to SMC 16(a), most respondents did not answer this SMC. Three of those that did agreed with the characteristics set out in paragraph 5.34 of Framework–CP2.

147. Staff believes that this issue should be dealt with in tandem with SMC 16(a), and therefore requires the same action.

**Review of Responses to Conceptual Framework Phase 2 Consultation Paper
Extract of Draft Minutes of IPSASB September 2011 Meeting
(Note: these draft minutes have not yet been approved by the IPSASB)**

6.4 Discuss Responses to Phase 2 Consultation Paper (Agenda Item 4C)

The Chair welcomed Alister Mason, the consultant who had carried out the initial analysis of responses to the Phase 2 Consultation Paper (CF-CP2). The contribution of Yangchun Lu in compiling the collation of responses was acknowledged. As at August 30, 2011 35 responses had been received to CF-CP2.

Staff highlighted that CF-CP2 included 19 Specific Matters for Comment (SMCs), most of which had two or three parts. Because of the large number of SMCs the objectives at this meeting were to (a) carry out a preliminary review of the responses, (b) obtain directions on the approach to be adopted in the development of the Phase 2 Exposure Draft (CF-ED2), where appropriate, and (c) identify issues for further detailed consideration at the December meeting. Where issues were deferred for consideration at the December meeting, Members were requested to provide suggestions of further analyses or other information that could be provided by staff to facilitate decisions.

The responses were reviewed in the order in which the SMCs were set out in CF-CP2, except that the approach to determining revenues and expenses (SMC 11) was considered first, because of its pervasive importance. The decisions made by the IPSASB on the SMCs are set out below.

SMC 11(a) and (b): Approach to determining revenues and expenses

The two parts of SMC 11 were discussed together: (a) whether the revenue and expense-led (R&E-led) approach, or the asset and liability-led approach (A&L-led), should be used in determining revenues and expenses; and (b) the arguments supporting the favored approach. It was noted that a small majority of respondents had supported the A&L-led approach, but that there had also been very significant support for the R&E-led approach. There had also been widely-varying views of the impact of the two approaches, with one respondent considering that, in most circumstances, the approaches would yield identical results and others indicating that they found the examples in CF-CP2 confusing.

Among the arguments raised in support of the revenue and expense-led approach were (a) that it results in a more accurate measure of the inflows and outflows of the entity during the period, and (b) that it provides a clearer alignment with the budgetary frameworks under which most public sector entities operate. Proponents believe that it facilitates inter-period equity, and fully reflects the annual financial cycle.

Those supporting the A&L-led approach maintain that it permits more robust definitions of elements, and avoids both (a) the subjectivity of determining the applicability of revenues and expenses to particular periods, and (b) having to recognize deferred inflows and deferred outflows. Proponents of the A&L-led approach consider that, in contrast to the revenue and expense-led approach, it properly represents economic phenomena. A number of respondents supporting the A&L-led approach noted that it is reflected in the existing IASB *Framework* and questioned why the IPSASB was envisaging departing from that Framework.

It was suggested that contrasting the two models as polar opposites might not be the way forward. The IPSASB confirmed staff's view that these two SMCs should be discussed in more detail at the December meeting.

SMC 1(a) and (b): Defining an asset

SMC 1 had sought views on (a) whether the types of benefits to be included in the definition of an asset should include (i) service potential, (ii) net cash inflows and (iii) unconditional rights to receive resources; and (b) whether the term to be used in the definition should be “economic benefits and service potential” or just “economic benefits”.

SMC 1(a): The respondents who commented on this SMC were almost evenly divided between those that favored the inclusion of all three types of benefits in the definition of an asset and those that favored the inclusion of just some of them in the definition. Among the latter group, almost all would include both service potential and net cash flows. However, considerable reservations were expressed about unconditional rights to receive resources, for reasons including its ambiguity, related measurement uncertainties and its possible contingent nature. Members confirmed staff’s view that SMC 1(a) should be discussed in more detail at the December meeting.

SMC 1(b): A majority of respondents supported the inclusion of both economic benefits and service potential in the definition of an asset. Many noted that public sector entities’ primary role is the delivery of services rather than cash-generation. A minority supported the inclusion of only economic benefits and considered that the term “economic benefits”, includes service potential and regarded a specific reference to “service potential” as superfluous. While there was some concern that referring to service potential in addition to economic benefits would involve a departure from the IASB definition, Members confirmed staff’s view that both economic benefits and service potential should be used in the definition of an asset. There was tentative agreement that the wording should be “service potential and/or economic benefits”.

SMC 2: Approach to associating an asset with a specific entity

SMC 2(a) asked which of three approaches- control; risks and rewards; and access to rights, including the right to restrict or deny access to rights, should be used to associate an asset with a specific entity. Close to half of the respondents who commented on SMC 2(a) viewed control as being the appropriate criterion for associating an asset with a specific entity. A few supported risks and rewards and a few access to rights.

Staff supported the views of the majority of respondents and cited the view in CF-CP2 that control allows an entity to determine whether to (i) directly use the present service potential to provide services to citizens; (ii) exchange the present service capacity for another asset; and (iii) employ the asset in any of the other ways it may provide benefit. Without control, one or more of these attributes may not be possible.

The IPSASB tentatively confirmed staff’s view that, of the three suggested approaches to associating an asset with a specific entity, control should be used as the primary criterion for associating an asset with a specific entity.

SMC 2(b) asked whether an entity’s enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others’ access links a resource to a specific entity. Respondents were almost equally divided between those that agreed and disagreed with the principle underlying the SMC.

The IPSASB confirmed staff’s view that SMC 2(b) should be discussed in more detail at the December meeting. Members also directed staff to consider the implications of the IASB’s project on leases.

With regard to **SMC 2(c)** – whether additional requirements are necessary to establish the link between the entity and an asset – the IPSASB tentatively confirmed staff’s view that no additional requirements are necessary.

SMC 3: Past event necessary to definition of an asset?

SMC 3 asked whether it is sufficient that the definition of an asset refers to a “present” resource, or whether a past event must be incorporated in the definition. A few respondents thought that it is sufficient to state that an asset is a present resource. More respondents considered that a past event must occur. A significant number of respondents thought that, while identification of a past event is helpful, it is not necessary for there to have been a past event. Staff put forward the view that, while a past event is a highly useful indicator of the existence of a present resource, it is not an essential characteristic.

The IPSASB did not confirm the Staff View. A view was expressed that the point at which an item becomes an asset is difficult to determine if a past event cannot be identified. It was decided that **SMC 3** should be discussed in more detail at the December meeting.

SMC 6: Defining a liability

SMC 6 (a) had asked whether the definition of a liability should cover all of four types of obligation:

- (i) Obligations to transfer benefits, defined as cash and other assets, and the provision of goods and services in the future;
- (ii) Unconditional obligations, including unconditional obligations to stand ready to insure against loss (risk protection);
- (iii) Performance obligations; and
- (iv) Obligations to provide access to or forego future resources.

One Member commented that some of the responses were not clear about the types of obligation to be included in the definition of a liability. It was generally felt that, in particular, more work was needed to understand the respondents’ views on type (iv) – obligations to provide access to or forego future resources.

The IPSASB confirmed staff’s view that **SMC 6(a)** should be discussed in more detail at the December meeting.

SMC 6(b) had asked whether the requirement for a settlement date is an essential characteristic of a liability. A very large majority of respondents considered that a settlement date is not an essential characteristic of a liability, although some considered that a settlement date helps to identify a liability. Staff agreed with this view.

Members agreed with the view of most respondents. One Member noted that economists observe that currency in circulation has no settlement date. Members considered that the key points are that there is an obligation to repay, not a repayment date, and that a settlement date is an indicator of a liability, not an essential characteristic.

The IPSASB confirmed staff’s view that the requirement for a settlement date is not an essential characteristic of a liability.

SMC 7: Specific external party needed to define a liability, and approach to avoiding an obligation

SMC 7(a) asked whether 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 part of the supplementary discussion. A large majority of respondents expressed a view that the ability to identify a specific outside party(ies) is not an essential characteristic of a liability. Staff supported this view and noted that, in the public sector, there are many instances where a specific party outside the reporting entity cannot be identified in relation to a liability, e.g., environmental remediation. In staff's view the omission of such obligations would result in an understatement of liabilities.

The IPSASB confirmed staff's view that the ability to identify a specific external party(ies) is not an essential characteristic in defining a liability.

SMC 7(b) asked whether the absence of a realistic alternative to avoid an obligation is an essential characteristic of a liability. Staff expressed a view that, while a large majority of respondents had agreed that the absence of a realistic alternative, to avoid an obligation is an essential characteristic of a liability, it seemed questionable whether there is a consensus on what a realistic alternative to avoiding an obligation entails. The IPSASB confirmed staff's view that this issue should be discussed in more detail at the December meeting.

SMC 7(c) put forward three approaches in determining whether an entity has a realistic alternative to avoid an obligation and asked respondents which of these approaches they support. The approaches were:

- (a) Enforceable contractual, constructive, and equitable obligations.
- (b) Enforceable contractual, constructive, and equitable obligations and other constructive and equitable obligations associated with exchange transactions.
- (c) Enforceable contractual, constructive, and equitable obligations and all other constructive and equitable obligations from which the public sector entity cannot realistically withdraw.

There was not a majority for any of the options. A small number of respondents favored approach (a) whereby liabilities are limited to enforceable obligations for both exchange and non-exchange transactions. A similar number favored approach (b). In this approach, liabilities for non-exchange transactions, but not exchange transactions, only arise from enforceable obligations. A larger number of respondents favored approach (c), whereby liabilities for both exchange and non-exchange transactions would not be limited to enforceable obligations.

It was suggested that the discussion in CF-CP2 had been abstruse and, in particular, confusing to non-native English speakers. A number of Members emphasized the huge importance of this issue in the public sector and the difficulty in resolving it. The IPSASB confirmed staff's view that discussion of SMC 7(c) should be continued at the December meeting.

SMC 8: Past event necessary to definition of a liability?

SMC 8 asked whether it is sufficient to state that a liability is a "present" obligation, or whether there must be a past event. Nearly one third of respondents considered that it was sufficient for a liability to be a present obligation. A larger number responded that

identification of a past event is necessary. A smaller, but significant, number of respondents took an intermediate position: that a past event is helpful or desirable, but not necessary.

Staff suggested that, while a past event is useful evidence of the existence of a liability, it is not an essential characteristic. Members considered the staff view insufficiently developed and did not confirm that view. It was decided that SMC 8 should be discussed further at the December meeting together with the necessity of a past event to the definition of an asset.

SMC 9: Whether public sector entity obligations arise only from enforceable claims

SMC 9(a) asked whether, recognition and measurement criteria aside, public sector entity obligations such as those associated with a government's duties and responsibilities are perpetual obligations, obligations only when they are enforceable claims, or whether there is an appropriate intermediate event that is more appropriate.

A few respondents considered public sector entity obligations to be perpetual obligations. A larger number of respondents saw public sector entity obligations as obligations only where there are enforceable claims. It was noted that one respondent considered obligations to provide social benefits to be liabilities that may qualify for recognition, but does not support depicting such obligations as 'perpetual obligations' because they are continually settled and replaced with new obligations.

The importance of considering this issue together with the approach to public sector powers and rights in the context of assets, so that positions on both assets and liabilities are internally consistent, was emphasized. The IPSASB confirmed staff's view that discussion of SMC 9(a) will be continued at the December meeting.

SMC 9(b) asked whether the enforceability of an obligation is an essential characteristic of a liability. Staff noted that it addressed a similar issue to SMC 7(c), but that, in a number of cases, responses to these two SMCs appeared inconsistent. Over half the respondents considered that enforceability is essential. A substantial minority disagreed. The IPSASB confirmed staff's view that discussion of SMC 9(b) should be continued at the December meeting.

SMC 9(c) asked whether the definition of a liability should include an assumption about the role that sovereign power plays, such as by referring to the legal position at the reporting date. CF-CP2 noted that some suggest that sovereign power enables a government to walk away from many of its obligations. About half of the respondents expressing a clear view on this issue considered that the liability definition should include an assumption about sovereign power, while the other half expressing a clear view considered that it need not include such an assumption.

Staff considered that the wording of SMC 9(c) may have suggested a degree of disagreement amongst respondents that does not exist. Staff had concluded that the large majority of respondents agreed that the existence of sovereign power should not be used as a rationale for the non-recognition of obligations that otherwise meet the definition of a liability and the recognition criteria. However, where there appeared to be less agreement was whether such an assumption needed to be explicit in the definition.

Staff proposed that the determination of whether a liability exists should be by reference to the legal position at the reporting date, but that this might be addressed in supporting narrative rather than explicitly stated in the definition of a liability. Members considered

that the staff position was insufficiently well developed. It was decided that SMC 9(c) should be discussed in more detail at the December meeting.

SMC 12: Exclude transactions with residual/equity interests from revenues/expenses?

SMC 12(a) asked whether transactions with residual/equity interests should be excluded from revenues and expenses. About two thirds of those expressing a clear view on this issue considered that transactions with equity interests should be excluded from revenue and expenses.

The IPSASB confirmed staff's view that SMC 12(a) should be discussed in more detail at the December meeting, when element definitions will be further considered.

SMC 12(b) asked whether the definitions of revenue and expense should be limited to specific types of activities associated with operations. Just under a quarter of respondents supported limiting the definitions to specific types of activities, but the majority did not support such a limitation.

The IPSASB confirmed staff's view that SMC 12(b) should be discussed in more detail at the December meeting when element definitions will be further considered.

SMC 14: Need to identify deferrals on the statement of financial position?

SMC 14(a) asked whether deferrals need to be identified on the statement of financial position in some way. Over half the respondents providing comments favored identifying deferrals on the statement of financial position, while over one-third did not. Many of those opposing the identification of deferrals expressed support of the determination of revenues and expenses by the asset and liability-led approach in SMC 11(a).

The IPSASB confirmed staff's view that SMC 14(a) should be discussed in more detail at the December meeting, in conjunction with SMC 11(a).

SMC 14(b) asked, if 14(a) was answered affirmatively, which of three specified approaches is most appropriate for defining deferred outflows/inflows:

- (i) Defining such flows as separate elements;
- (ii) Including such flows as sub-components of assets and liabilities; or
- (iii) Including such flows as sub-components of net assets/net liabilities.

This issue was not applicable to many respondents since they had indicated in SMC 14(a) that they did not support the identification of deferrals. Of those responding to SMC 14(b), about two-thirds favored defining deferred inflows/outflows as separate elements, with most of the rest wanting to include them as sub-components of assets and liabilities. The IPSASB confirmed staff's view that SMC 14(b) should be discussed in more detail at the December meeting.

SMC 14(c) asked whether, if defined as separate elements, the definitions of deferred outflow/deferred inflow set out in CF-CP2 are appropriate and complete:

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

A relatively small number of respondents commented in this issue, as it was only relevant for those that had indicated that deferred outflows should be separate elements in SMC 14(b). Just over half of these respondents considered the definitions to be appropriate and complete. The IPSASB confirmed staff's view that SMC 14(c) should be discussed in more detail at the December meeting, in conjunction with SMC 11(a).

SMC 17: Requirements for recognition criteria

SMC 17(a) asked whether recognition criteria should address evidence uncertainty by requiring evidence thresholds; 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.

Of the respondents that provided a clear answer to this issue, few favored addressing evidence uncertainty by requiring evidence thresholds. One of that minority stated that evidence thresholds provide the most pragmatic approach, and simplest for users to understand. The majority of those expressing a clear view supported using neutral judgment to review and assess all available evidence in determining whether there is sufficient evidence to recognize an asset or liability initially, whether it continues to qualify for recognition, or whether there has been an addition to an existing asset or liability.

The IPSASB confirmed staff's view that a neutral judgment should be applied in assessing whether an element exists at the reporting date, based on an assessment of all available evidence.

SMC 17(b) asked whether there should be a uniform threshold for both assets and liabilities. Since the IPSASB supported the use of neutral judgment, no decision was required on thresholds.

SMC 4: Whether public sector rights/powers are inherent assets

SMC 4 asked whether, recognition and measurement criteria aside, public sector entity rights and powers, such as those associated with the power to tax and levy fees, are inherent assets of a public sector entity, are assets only when those powers are exercised, or whether there is an intermediate event that is more appropriate?

Most respondents agreed with the view that such powers only give rise to assets when the powers are exercised. Staff considered the views persuasive. A number of Members supported the staff view. However, a converse view was put forward that the exercising of powers is a recognition issue rather than one intrinsic to the definition.

The IPSASB was not prepared, at this time, to confirm the staff view. It was decided that SMC 4 should be discussed in more detail at the December meeting. Staff was also directed to consider the obverse issue of continuing public sector obligations.

SMC 5: Additional characteristics/issues re assets

SMC 5(a) asked whether there are any additional characteristics that have not been identified that are believed to be essential to the development of an asset definition.

The IPSASB confirmed staff's view that no additional characteristics are essential to an asset definition.

SMC 5(b) asked whether there are other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of assets.

The IPSASB confirmed staff's view that no other relevant issues had been identified that need to be considered in determining the concept of assets.

SMC 10: Additional characteristics/issues re liabilities

SMC 10(a) asked whether there are any additional characteristics that have not been identified that are believed to be essential to the development of a liability definition. The IPSASB confirmed staff's view that no additional characteristics had been identified that are essential to the definition of a liability.

SMC 10(b) asked whether there are other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of liabilities.

The IPSASB confirmed staff's view that there are no other relevant issues that need to be considered in determining the concept of liabilities.

SMC 13: Additional characteristics re revenues and expenses

SMC 13(a) asked whether there are any additional characteristics that have not been identified that are believed to be essential to the development of definitions of revenues and expenses.

The IPSASB confirmed staff's view that no additional characteristics had been identified that is essential to the definitions of revenues and expenses.

SMC 13(b) asked whether there are other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the definitions of revenues and expenses.

The IPSASB confirmed staff's view that SMC 13(b) should be discussed in more detail at the December meeting, at the time SMC 11(a) and related issues are resolved.

SMC 15: Net assets/net liabilities and ownership interests

SMC 15(a) asked whether net assets/net liabilities are considered to be a residual amount, a residual interest, or an ownership interest. Among the respondents who expressed a clear view on this issue, nearly half considered net assets/net liabilities to be a residual amount, a few considered it to be a residual interest, one an ownership interest, and several thought that it depended on the entity or the jurisdiction.

The IPSASB confirmed staff's view that SMC 15(a) should be discussed in more detail at the December meeting, at the time SMC 11(a) and related issues are resolved.

SMC 15(b) asked whether the concept of ownership interests, such as those that relate to minority or non-controlling interests in a GBE, should be incorporated in the element definition. A few respondents favored incorporating the concept of ownership interests in the element definition, and nearly half of them opposed this treatment. The others did not express a clear view on the issue. The IPSASB confirmed staff's view that the concept of ownership interests should not be incorporated in the element definition.

SMC 15(c) asked whether there are other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of net assets/net liabilities.

The IPSASB confirmed staff's view that no other issues had been identified to consider in determining the concept of net assets/net liabilities.

SMC 16: Transactions with residual/equity interests

SMC 16(a) asked whether transactions with residual/equity interests should be defined as separate elements. A minority of respondents favored defining transactions with residual/equity interests as separate elements on the basis that because residual or equity interests should be distinguished from other elements, they should be identified as a separate element.

The IPSASB confirmed staff's view that SMC 16(a) should be discussed in more detail at the December meeting, taking into account discussion of the other elements.

SMC 16(b) asked whether, if residual/equity interests were defined as separate elements, what characteristics would be essential to their definition. The IPSASB confirmed staff's view that SMC 16(b) should be discussed in more detail at the December meeting, taking into account discussion of the other elements.

SMC 18: Criteria for recognition/derecognition

SMC 18 asked whether the same criteria should be used for derecognition as for initial recognition. A large majority of respondents supported using the same criteria. Among the points raised were that, if different criteria are used, this may result in assets/liabilities that no longer meet the definition and recognition criteria being reflected in the financial statements, thereby distorting the faithful representation and relevance of the statements. The IPSASB confirmed staff's view that the same criteria should be used for derecognition as for initial recognition.

SMC 19: Recognition criteria part of element definitions?

SMC 19 asked whether the recognition criteria should be an integral part of the element definitions, or separate and distinct requirements.

A large majority of those responding to this issue favored separate and distinct requirements for recognition criteria. Those opposing this view generally considered that recognition is integral to the definition of an element or that this would be more convenient for the users

While staff acknowledged the views of those who consider that the integration of definitions and recognition criteria is helpful to preparers, staff agreed with the view that meeting the element definition and recognition are two separate processes and therefore that the recognition criteria should be separate and distinct from element definitions. The IPSASB confirmed staff's view that the recognition criteria should not be integrated in element definitions.

Next steps

Staff was directed to group the SMCs on which decisions had not been made into themes rather than listing them sequentially. These themes were to be agreed with the Task Based Group on Phase 2. Members and TAs were asked to provide staff with ideas for additional analyses or material to facilitate decisions at that time. Assuming that all the necessary decisions can be made in December, a first draft of CF-ED2 will be presented at the March 2012 meeting.