The Chartered Institute of
Public Finance & Accountancy

IPSASB Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

Exposure Draft
- Role, Authority and Scope;
- Objectives and Users;
- Qualitative Characteristics; and
- Reporting Entity

Consultation Paper
- Elements and Recognition in Financial Statements

Consultation Paper
- Measurement of Assets and Liabilities in Financial Statements

responses to exposure draft and consultation papers

15 June 2011

the people
in public finance

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CANADA
Submitted electronically
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Dear Stephenie Fox

IPSASB Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

Exposure Draft: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity

Consultation Paper: Elements and Recognition in Financial Statements

Consultation Paper: Measurement of Assets and Liabilities in Financial Statements

CIPFA is pleased to present its responses to these three consultations, which have been reviewed by CIPFA's Accounting and Auditing Standards Panel.

General comment

CIPFA strongly supports IPSASB's programme which helpfully develops public sector specific IPSASs on matters which are unique to the sector, and IFRS converged IPSASs on matters which are relevant to both private and public sectors. The conceptual work will inform the development of standards in future and we support the objective of achieving an optimum balance between maintaining comparability between sectors and addressing sector specific issues.

CIPFA therefore welcomes the continuing development of IPSASB's important work in developing a conceptual framework for public sector financial reporting, which will be helpful both where IPSASs are developed for circumstances covered by IFRS, and when dealing with sector specific matters. The importance of this work is particularly clear given developments in IFRS which may make it more difficult to apply those standards or the IASB conceptual framework directly to the circumstances of public sector entities. Because this work is so important, it is vital that the development of the framework is rigorous and is followed up by standards developed in an equally rigorous manner, supported through transparent consultation.

In the Board's previous consultation UK stakeholders expressed reservations about the widening of scope beyond matters which have traditionally been included in public sector financial reporting. CIPFA welcomes the current Exposure Draft's explanation of the way in which the Board approach the evolution of wider scope reporting. In particular we welcome the acknowledgement that IPSASB may address wider reporting needs through non-authoritative guidance. Even so, we would note that the Board has limited resources, and is committed to a substantial workload in completing development of the Conceptual Framework and more mainstream development such as an IPSAS on Entity Combinations and 'maintenance' of converged IPSAS, such as Financial Instruments, where the relevant IFRS are undergoing substantial change. Given this we would urge caution in pursuing development of wider reporting beyond those topics, such as Long Term Fiscal

Sustainability, which the Board has included in its work plan after specific consultation on the Board's agenda.

Specific Matters for Comment

CIPFA responses to the Specific Matters on which IPSASB would particularly value comment are provided for each of the three consultations, attached at Annexes A to C.

I hope this is a helpful contribution to the finalisation of IPSASB guidance. If you have any questions about this response, please contact Steven Cain (e:steven.cain@cipfa.org.uk, t:+44(0)20 7543 5794).

Yours sincerely
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CIPFA responses to the Specific Matters on which IPSASB would particularly value comment

IPSASB Exposure Draft CF-ED1

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity

Specific Matters for Comment
1. Role, authority and scope of the Conceptual Framework
CIPFA agrees with - the role and authority of the Conceptual Framework set out in the Exposure Draft - the scope of financial reporting as set out in the Exposure Draft. In line with previous comments on Preliminary View 1 and Preliminary View 5 of the 2008 Consultation Paper, in which all UK stakeholders expressed reservations about the widening of scope, CIPFA welcomes the explanation of the way in which the Board approach the evolution of wider scope reporting, and in particular we welcome the acknowledgement that IPSASB may address wider reporting needs through non-authoritative guidance.
2. Objectives of financial reporting by public sector entities and the primary users of GPFRs of public sector entities and their information needs;
In line with the comments on Preliminary View 4 of the 2008 Consultation Paper, CIPFA agrees with the objectives as set out in the Exposure Draft.

3. Qualitative characteristics of, and constraints on, information included in GPFRs of public sector entities. In particular, whether:

(a) "Faithful representation" rather than "reliability" should be used in the Conceptual Framework to describe the qualitative characteristic that is satisfied when the depiction of an economic or other phenomenon is complete, neutral, and free from material error; and

(b) Materiality should be classified as a constraint on information that is included in GPFRs or as an entity-specific component of relevance;

In line with the comments on Preliminary View 7 of the 2008 Consultation Paper, CIPFA agrees with the proposed qualitative characteristics and constraints on financial reporting.

We therefore support the use of 'faithful representation': in this case we agree that the advantages of alignment are greater than the improvements that would be secured by IPSASB using "reliability". We note that the Exposure Draft does not include the distinction between 'fundamental' and 'enhancing' characteristics which is made in the IASB Conceptual Framework. We suggest that this issue is revisited in the light of the development of other areas of the Conceptual Framework such as Presentation.

In the response to IPSASB's 2008 Consultation Paper, we also supported the classification of materiality as a constraint while asking for additional discussion of context. Additional discussion of the contextual aspects of materiality is provided in the ED and this is very helpful.

The articulation of materiality as a constraint is in line with the similar proposal in the IASB/FASB joint Exposure Draft issued in 2008, which echoed the then current FASB Concepts Statement. As noted at Appendix 3A of IPSASB CF ED 1, the IASB in September 2010 published a revised chapter on Qualitative Characteristics which articulated materiality as an entity specific component of Relevance, and moved this material from the 'constraints' discussion to the section on fundamental qualitative characteristics. FASB made similar changes in their Concepts Statement No. 8.

We would agree with the suggestion that materiality is an entity specific component of relevance, but we would note that perhaps a key aspect of how it is applied to standard setting is when considering constraints on financial reporting, particularly the cost-benefit constraint.

4. The basis on which a public sector reporting entity is identified and the circumstances in which an entity should be included in a group reporting entity.

The Exposure Draft has restructured the material in the Consultation Paper, taking the view that certain matters should be dealt with at standards level. Comment on entity definition was provided in respect of Preliminary View 8, and particularly in Preliminary View 9 of the 2008 Consultation Paper where UK stakeholders including CIPFA were concerned that additional flexibility would be needed. We are content with the proposals in the Exposure Draft.

CIPFA responses to the Specific Matters on which IPSASB would particularly value comment

IPSASB Consultation Paper

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements

Specific Matter for Comment 1 (a) 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? (b) What term should be used in the definition of an asset: (i) Economic benefits and service potential; or (ii) Economic benefits?
(a) All of these should be recognised (b) While we accept that the term 'Economic Benefits' can be taken to encompass wider considerations such as the benefit provided by public services, we suggest that Option (i) is the clearest and most helpful formulation for the Framework, particularly as it avoids confusion with the narrow usage of economic benefits by the IASB, where it is considered purely in terms of profit seeking activities. That said, we do consider that service potential can be measured by reference to economic benefit even in the narrow sense, having regard to expenditures which would be made to provide the equivalent service.

Specific Matter for Comment 2

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

(i) Control;

(ii) Risks and rewards; or

(iii) Access to rights, including the right to restrict or deny others' access to rights?

(b) 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?

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

(a) On balance, while none of the proposed bases are without drawbacks, we consider that 'control' best links an asset with a specific entity. However further consideration will need to be given when developing this section of the framework as to whether 'control' refers to (inter alia):

- the ability to exercise control or actual exercise of control;
- exposure or rights to variable outcomes arising from the asset;
- control over the asset or the service delivery capacity of the asset.

While even in the private sector there is debate over which base should be used, the bases are less clearly defined in the public sector than in the private sector because of the functions, diverse nature, structure and legal powers of public sector entities.

(b) We consider that an entity's enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others' access are essential characteristics of an asset.

(c) There are no additional requirements that CIPFA is aware of.

Specific Matter for Comment 3

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

CIPFA considers that there must have been an event, or a series of events, that result in the creation of an asset. However in practice the difficulty is often whether there is an 'identifiable' past event.

We consider that the need for an identifiable past event should not in principle limit the recognition of an asset. Instead, the more essential consideration is whether there exists a present resource available to the entity to meet its future obligations or contribute to the entity's service potential.

Having said all of the above, we would note that the 'past event' approach may be helpful in providing a trigger for recognition in particular IPSAS standards.

Specific Matter for Comment 4

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

We consider that the power to tax and levy fees is in itself an asset.

However in our view it would be difficult to develop a workable approach to recognising and measuring a theoretical power to tax.

We therefore agree that when developing IPSAS standards which relate to assets, the power to tax and levy fees should be considered as assets only when:

- those powers are exercised; and
- the tax or levy due can be measured in such a way as to provide a faithful representation of the asset.

Specific Matter for Comment 5

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

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

(a) We have not identified any additional characteristics

(b) Arguably one of the greatest assets of the State to its population is social capital. For example the rule of law and associated property rights and good governance in the conduct of government through the avoidance of corruption and extortion. By permitting the peaceful and lawful enjoyment of property, commerce and trade is facilitated, innovation encouraged through maintenance of intellectual property rights, savings and investments are encouraged and so overall economic well being is enhanced. This is both a benefit in itself, and will generally result in a greater tax base and higher tax revenues.

The framework should acknowledge these kinds of asset exist and have a powerful effect on government finances.

However, in line with our discussion on Specific Matter for Comment 4 above, we suggest that for reasons of practicality these should not in general be recognised in financial statements.

Specific Matter for Comment 6 (a) 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. (b) Is the requirement for a settlement date an essential characteristic of a liability?
In answering this question, CIPFA has been careful not to assume a fully worked out definition of a public sector liability – this is a matter on which although IPSASB and others have consulted a number of times, and an internationally acceptable consensus has yet to emerge. (a) CIPFA considers that elements (i), (ii), and (iii) should be included in the definition of a liability. It is not clear to us how item (iv) differs from item (i) and we are not sure that any items not encompassed by (i) should be deemed to be liabilities. (b) No. Requiring a settlement date would exclude, for example, important and decision useful information relating to expected payments of uncertain timing.
Specific Matter for Comment 7 (a) Should the ability to identify a specific party(ies) outside the reporting entity to whom the entity is obligated be considered an essential characteristic in defining a liability, or be part of the supplementary discussion? (b) Do you agree that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability? (c) Which of the three approaches identified in paragraph 3.28 do you support in determining whether an entity has or has not a realistic alternative to avoid the obligation?
In answering this question, CIPFA has again been careful not to assume a fully worked out definition of a public sector liability. (a) We do not consider the ability to identify specific parties as an essential characteristic, although liabilities will generally relate to parties outside the reporting entity which can be identified in general terms. (b) Yes. However it must be recognised that certain public sector entities are able to change the law such that they could negate a liability. The Framework should therefore consider what constitutes 'realistic' in the context of law making entities. (c) For the reasons outlined in paragraph 3.35, we consider that 3.28 (c) provides the best approach: Enforceable contractual, constructive, and equitable obligations and all other constructive and equitable obligations from which the public sector entity cannot realistically withdraw.

Specific Matter for Comment 8 Is it sufficient to state that a liability is a "present" obligation, or must there be a past event that occurs?
CIPFA considers that there must have been an event, or a series of events, that result in the creation of a liability. However in practice the difficulty is often whether there is an 'identifiable' past event. We consider that the need for an identifiable past event should not limit the recognition of a liability. Instead, the more essential consideration is whether there exists a present obligation. Having said all of the above, we would note that the 'past event' approach may be helpful in providing a trigger for recognition in particular IPSAS standards.
Specific Matter for Comment 9 (a) 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? (b) Is the enforceability of an obligation an essential characteristic of a liability? (c) 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?
(a) Consistent with the response to Specific Matter for Comment 7, we consider that the obligations which might potentially be recognised and measured as a liability should be those where there is no realistic alternative to avoid the obligation. While there may be a sense in which obligations arise from general duties and responsibilities, for reasons of practicality an approach which focuses on enforceability of claims or unavoidability is a better fit for liability definitions. The factors that would trigger a liability are likely to vary between jurisdictions, depending on legal systems, specific legislation and political factors. Inasmuch as there may be intermediate events relating to liabilities, these will mainly relate to determination that enforceable claims will occur or are likely to occur, even though the recipients have yet to be determined. (b) Yes. As noted above enforceability can arise from contractual, constructive political or moral obligations. (c) As is discussed at 3.59 - 3.60 of the Consultation Paper, sovereign powers may allow a government to avoid its liabilities for example by changing legislation. However we consider that it is necessary to assume that at the balance sheet date the government will meet all its liabilities that it is required to recognise under the relevant financial reporting framework and legislation in place at that time.

Specific Matter for Comment 10

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

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

(a) No.

(b) No, although in the absence of an agreed definition we suggest that the discussion of public sector liabilities must, like the private sector discussions of the distinction between provisions and contingent liabilities, have regard to significant commitments which, while possibly avoidable or otherwise not recognisable as liabilities, are planned as part of the ongoing responsibilities of the reporting entity.

Specific Matter for Comment 11

(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?

(a) CIPFA considers that the most coherent and useful approach is to determine revenue and expenses by reference to changes in net assets during the period

(b) While this is generally represented as the assets and liabilities approach it is not principally focused on assets and liabilities as ends in themselves. The approach provides a coherent and consistent way of defining revenue and expense flows to reflect economic substance, without the difficulties and risk of bias inherent in defining ‘applicability’.

Specific Matter for Comment 12

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

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

(a) Defining equity or ‘ownership’ interest is particularly problematic for public sector entities, but this can usefully be conceived of as a residual. Current frameworks usefully distinguish flows to and from ‘ownership’ interests from the headline performance measure of operational activity and we consider that this is helpful

(b) No. But at a standards level, it may be useful to separately disclose information on revenue and expenses associated with operations, for example in contrast to changes in financial position which arise from exogenous factors such as changes in market values.

Specific Matter for Comment 13 (a) Are there any additional characteristics that have not been identified that you believe are essential to the development of definitions of revenues and expenses? (b) 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?
(a) No (b) No
Specific Matter for Comment 14 (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?
(a) No. Deferrals do not need to be identified on the SOFP. The deferral models proposed seem to be based on considerations of inter-period equity which provide information which is important in some jurisdictions. However, while interperiod and intergenerational equity are important considerations, there is no consensus on whether or if there should be specific measurement and disclosure in Statements of Financial Position. Recognition is also likely to be problematic and potentially subjective. We consider that deferral information may often be relevant information, which should be brought to the attention of readers of financial reports, perhaps through narrative reporting, including in jurisdictions which do not primarily focus on inter-period equity. We do not however consider such deferrals to be elements of financial statements applicable in an international context.

Specific Matter for Comment 15 (a) Do you consider net assets/net liabilities to be a residual amount, a residual interest, or an ownership interest? (b) Should the concept of ownership interests, such as those that relate to minority or noncontrolling interests in a GBE, be incorporated in the element definition? (c) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of net assets/net liabilities?
(a) We consider that in general net assets/net liabilities should be treated as a 'residual interest'. However where an entity is financially accountable to another entity (even where the 'parent' cannot direct or control the operational policies of the 'subsidiary'), it may be helpful to treat the net assets/net liabilities as effectively constituting an 'ownership interest'. A relevant scenario is outlined in paragraph 5.19. An ownership interest might also occur if a jurisdiction allows private investment in a government owned entity. Also where funds or assets are held on trust by the government it may be useful to separately identify the interests of donors and the public, for example where a museum collection is gifted to the state. (b) No. CIPFA considers that this could be dealt with as a sub-category of liabilities. (c) Not that we are aware of.
Specific Matter for Comment 16 (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?
(a) Only where: - An 'ownership interest' exists as outlined above at Specific Matter for Comment 15 - The transactions are not related to operating activities (i.e. they are restricted to capital injections or payment to the 'ownership interest' by means of 'dividends' or other distribution of accumulated surpluses. (b) See above

Specific Matter for Comment 17 (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? (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?
(a) We support the use of an evidence threshold approach, but it is difficult to separate the discussion of whether an event has occurred which potentially warrants recognition, from consideration of whether a reliable measurement approach is available. (b) We agree that a uniform threshold should be adopted in principle for the recognition of both assets and liabilities. Inasmuch as the threshold relates to the likelihood that an asset or liability exists, we suggest that the starting point should be that it is ‘probable’ or ‘more likely than not’.
Specific Matter for Comment 18 Do you support the use of the same criteria for derecognition as for initial recognition?
Yes.
Specific Matter for Comment 19 Should the recognition criteria be an integral part of the element definitions, or separate and distinct requirements?
We consider that recognition is a distinct stage in the accounting process that takes place after considering whether an item meets the definition of an element.

CIPFA responses to the Specific Matters on which IPSASB would particularly value comment

IPSASB Consultation Paper

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Measurement of Assets and Liabilities in Financial Statements

Specific Matter for Comment 1

Should the role of the Framework be to identify factors that are relevant in selecting a measurement basis for particular assets and liabilities in specific circumstances, rather than specify a single measurement basis or combination of bases?

CIPFA considers that the framework should mainly identify the factors that are relevant in selecting measurement bases for assets and liabilities rather than specifying one or more measurement bases to be used.

It would be helpful if in doing this, the framework provided indicative guidance on the circumstances under which IPSAS standards might allow or require assets or liabilities to be measured on a historical or current value basis, however defined.

Specific Matter for Comment 2

If, in your view the Framework should specify a measurement basis or combination of bases (or approach in the case of deprival value), which should that be?

Single Measurement Bases

(a) Historical cost.

(b) Market value.

(c) Replacement cost.

Combinations of Bases/Approach

(d) Deprival value.

(e) Historical cost and market value.

(f) Replacement cost and market value.

(g) Historical cost, replacement cost, and market value.

Others

(h) Another measurement basis or combination of bases/approach.

Please explain why you support a particular measurement basis or combination of measurement bases/approach and your reasons for rejecting alternatives.

Per our answer to Specific Matter for Comment 1 above, we do not consider that the framework should specify measurement bases.

Specific Matter for Comment 3

The Consultation Paper discusses the following measurement bases: historical cost, market value, and replacement cost. It also discusses the deprival value concept which does not describe a single measurement basis, but rather a means by which a basis may be selected that is relevant to the circumstances. Value in use and net selling price are discussed in the context of the deprival value model.

In your view, is this discussion complete, balanced and fair? If not, please indicate what in your view is missing or in what respects you consider the discussion does not draw out the strengths and weaknesses of the various bases (or approach in the case of deprival value).

We agree that the discussion in the Consultation Paper is complete, balanced and fair.

Specific Matter for Comment 4

In your view, should:

(a) The effect of an entity's own credit risk be reflected in the measurement of liabilities at initial recognition; and

(b) The effect of changes in own credit risk be reflected when liabilities are subsequently remeasured?

In our answer to Specific Matter for Comment 1, we suggest that the framework should mainly identify the factors that are relevant in selecting measurement bases for assets and liabilities rather than specifying one or more measurement bases to be used. Given this, it is difficult to provide an answer to this question which may depend on the particular measurement approach applied to specific assets.

Having said this, we agree that some consideration should be given to own credit risk when determining the measurement of liabilities at initial recognition. As noted in paragraph A12 of the CP when a liability is issued for a consideration, the entity's credit risk affects the amount that is received in exchange for its issue. There are however practical difficulties associated with calculating own credit risk for some other categories of liabilities. We suggest that IPSASB would need to undertake research to establish to what extent a workable approach to own-credit risks can be developed before applying this approach widely in IPSAS standards.

We also agree that in principle there is an argument for reflecting changes in own credit risk when liabilities are subsequently re-measured. However we are not sure that a workable approach to such re-measurement can be developed. If own credit risk is included as part of re-measurement we suggest its application is limited to transactions where the link is identifiable, measurable and observable for example the issuance of debt or debt servicing obligations.

Specific Matter for Comment 5 In your view, where assets are not restricted in use and therefore may be sold for an alternative use, should the measurement reported in the statement of financial position reflect: (a) Only the service potential relating to the existing use; or (b) Include the incremental value relating to its possible sale for an alternative use?
In our answer to Specific Matter for Comment 1, we suggest that the framework should mainly identify the factors that are relevant in selecting measurement bases for assets and liabilities rather than specifying one or more measurement bases to be used. Given this, it is difficult to provide an answer to this question which may depend on the particular measurement approach applied to specific assets. However, on balance we expect that, - For assets utilised in a continuing service provision activity under the going concern basis, we would expect the measurement to primarily reflect the service potential relating to the existing use. - For assets held to obtain an economic return the measurement would, in the first instance reflect the assets value in existing use Having said this, in both cases information on net selling price may provide useful information to inform the reporting entity's decisions on whether to continue using the specific asset for the current purpose. Also where an activity is discontinued but the asset is retained for alternate use rather than disposed of then valuation based on alternate use may be appropriate. This might affect, for example, the value attributed to the service potential under certain circumstances, or might justify additional information provision in disclosures attached to the primary financial statements.