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Submitted to: [www.ifac.org](http://www.ifac.org)

Dear Stephenie

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

The Financial Reporting Standards Board (FRSB) of the New Zealand Institute of Chartered Accountants is pleased to submit its comments on the IPSASB's Consultation Paper *Elements and Recognition in Financial Statements*.

We would like to thank the IPSASB for devoting resources to the development of this Consultation Paper and encourage the IPSASB to continue providing a forum for international debate on these issues.

We have two key comments. First, we consider that the definition of assets and liabilities should be generic and allow for the identification of a wide range of rights and obligations, including the right to tax and social benefit obligations. Secondly we support an 'asset and liability-led approach' to the determination of revenues and expenses.

Our detailed comments are set out in an Appendix to this letter.

If you have any queries or require clarification of any matters in this submission, please contact Joanne Scott ([joanne.scott@nzica.com](mailto:joanne.scott@nzica.com)) in the first instance, or me.

Yours sincerely

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**Appendix – FRSB comments on the 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?

1. In relation to question 1(a) we support a definition of an asset that covers all three types of benefits listed.
2. In relation to question 1(b) we consider that either approach could be used. The critical issue is that the notion of service potential is included in the Framework. This can be achieved under both options (b)(i) and (b)(ii). In the case of option (ii) it could be achieved by stating in the Framework that the term economic benefits is to be read as having the same meaning as service potential or by using the argument that service potential is a subset of economic benefits (as per the argument set out in paragraph 2.24 of the Consultation Paper (CP)). Regardless of which approach is taken we consider that the discussion of assets in the proposed Framework should highlight that public sector entities may hold assets because of their ability to deliver goods and services in accordance with the entity's objectives, or to generate net cash inflows.

**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?

3. In relation to question 2(a) we support an approach that takes account of both control and access to rights, including the right to restrict or deny others' access to rights. Care needs to be taken when discussing rights of access to assets, as rights of access may, in themselves, be assets (we have provided an example illustrating the differing types of rights that may exist in relation to an asset at the conclusion of this response). The first step is therefore to identify the nature of the asset under consideration and then decide if that asset is an asset of the entity.
4. Although we support using access to rights as a means of associating an asset with an entity, we note that it can be difficult to do this without reference to control (hence our response that it may be necessary to take account of both control and access to rights). If an entity has access to benefits, including the right to restrict or deny access to others, then it also has the ability to utilise the present service capacity inherent in those benefits.
5. In relation to question 2(b) we do not consider that an enforceable claim to benefits, or ability to deny, restrict, or otherwise regulate others' access, is a prerequisite to linking an asset with an entity. It could be a useful indicator but should not be relied upon.

6. One example that illustrates how differing rights may arise in relation to an asset is the case of Crown Forestry Licences (CFLs) in New Zealand. Pending completion of Treaty Settlement claims the Government separated land ownership from rights to use and occupy land for commercial purposes (e.g., growing timber). Once claims leading to agreements to transfer land were finalised, both ownership of the land and the related CFLs were transferred to the claimant. The process of hearing claims took over 20 years and the transfer of CFLs to claimants is taking place over a period of years. Following transfer of land ownership from the Crown to Māori in fulfilment of a settlement, occupancy progressively returns to the Māori claimant as timber is harvested – over a period of up to 35 years. The claimant receives rental income from the licensee until the end of the lease period upon harvest of the standing crop. We consider that this example illustrates a range of differing asset types – all linked to one underlying asset.

**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?

7. We do not consider that identification of a past event is required in order for an asset to exist. The question of whether or not an asset exists should be answered by reference to present circumstances. However, we acknowledge that a past transaction or event may be useful as an indicator that an asset exists. We therefore support the statement in the CP that a past transaction or event may be regarded as “an indicator of evidence supporting the existence of a past resource” (paragraph 2.47).

**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?

8. We consider that the identification of assets (through application of the definition of an asset) should be independent of recognition criteria. We consider that a government’s rights/powers to tax and levy fees are assets. However, such assets might not qualify for recognition in the financial statements. The right to tax is a different asset from a taxation receivable. A taxation receivable may exist only once an event (such as the exercise of the rights/powers) has occurred. The recognition of any such taxation receivable would then be subject to recognition criteria.
9. We support the ideas presented in paragraphs 2.52 and 2.53 of the CP. However, rather than saying that such rights would still have measurement hurdles to overcome, we would prefer to say that, as with any assets, they would be subject to recognition criteria to determine whether they are recognised in the financial statements. If entities have significant unrecognised assets this could raise disclosure issues.

**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?

10. We have not identified any additional characteristics or other relevant issues.

### **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?

- 11. Consistent with our comments on specific matter for comment 4, we consider that liabilities should be defined generically and should not be limited to items that would be recognised in financial statements. We consider that there are two critical questions in identifying liabilities: (i) is there an obligation and (ii) can the entity avoid the obligation?
- 12. To the extent that an entity has no realistic alternative to avoid them, we agree that the types of obligations described in (a)(i) to (iii) are liabilities.
- 13. We have some reservations about (a)(iv). Our comments on (a)(iv) are as follows:
  - (a) There are two types of obligations in (a)(ii). We consider that each of them should be considered separately. We agree that an obligation to provide access could be a liability, if it were an obligation that the entity could not avoid.
  - (b) We do not agree that an obligation to forego future resources is a liability. Our concern centres around the fact that there must be an outflow of resources for a liability to exist. Obligations to forego future resources may not result in outflows of resources. An outflow of value, which occurs when an entity gives up rights to receive a future benefit, is not the same as an outflow of resources.
- 14. In relation to specific matter for comment 6(b) we consider that a settlement date is not an essential characteristic of a liability. Settlement date may be relevant in the context of a contract, but it is not always relevant or necessary.

### **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?

### **Note for Boards – the Three Approaches**

The three approaches outlined in paragraph 3.28 of the IPSASB 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.

- 15. In relation to 7(a) we do not consider that the ability to identify a specific party(ies) outside the reporting entity to whom the entity is obligated should be considered an essential characteristic in defining a liability. The definition of a liability should require that

there be an outflow of resources (from which an entity cannot realistically withdraw) but we do not consider that it is essential to identify the external party(ies) that will receive that outflow of resources.

16. In relation to 7(b) we agree that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability.
17. In relation to 7(c) we support option (b) in paragraph 3.28 of the CP but have reservations about the emphasis on constructive obligations.
18. Consistent with our comments on the definition of an asset, we support a broad definition of a liability, whilst acknowledging that some types of liabilities will be unlikely to meet recognition criteria. We consider that the definition of a liability should be applicable to all types of obligations with no distinction between exchange and non-exchange obligations. We suggest that rather than excluding certain non-exchange obligations from the definition of a liability, the IPSASB focus on whether obligations are conditional or unconditional. We consider that an entity has a liability only in respect of unconditional obligations and that many obligations to provide future benefits (in a non-exchange setting) would be conditional obligations. We also consider that the definition of a liability should encompass unconditional stand ready obligations.
19. We consider an entity has a liability when it has an unconditional obligation from which it cannot realistically withdraw, regardless of whether that obligation is contractual or constructive.

#### **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?

20. Consistent with our response on specific matter for comment 3, we consider that a past event may indicate the existence of a present obligation but it is not an essential component of the definition of a liability.

#### **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 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?

21. In relation to specific matter for comment 9(a), and consistent with our comments in relation to the definition of an asset, we support the perpetual obligations view outlined in the CP. The CP discusses how the nature of obligations can change over time, with future events crystallising the timing of outflows and the claimants. We agree that this is an appropriate way of describing the life cycle of some liabilities. However, we would also encourage the IPSASB to explicitly acknowledge that only some obligations will (i) meet the definition of a liability and (ii) meet the criteria for recognition in the financial statements.
22. In responding to specific matter for comment 7(b) we expressed the view that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability. Our response to specific matter for comment 9(b) is “No” but we note that in many cases those obligations that are enforceable will also be obligations that an entity

has no realistic way of avoiding. However, we consider that there are some obligations which will not be enforceable but which should nevertheless be acknowledged as liabilities (even if they are not recognised in the financial statements).

23. With regard to specific matter for comment 9(c) our comments on 9(a) may be relevant. If a generic definition of a liability focusing on unconditional obligations is adopted, some obligations of governments would be identified as liabilities, but not recognised because they do not meet recognition criteria. If a government's policies changed, some of these obligations might cease to be liabilities.

**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?

24. We consider that the notion of unconditional obligations is essential to the development of a liability definition. We acknowledge that public sector entities have a broader range of obligations than private sector entities, particularly in respect of social benefits. As discussed in the preceding matter for comment, a generic definition of a liability could lead to some of these broader obligations being identified as liabilities. Recognition would remain a separate issue.

**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?

25. We consider that revenues and expenses should be determined by an 'asset and liability-led approach'. We are strongly of the view that assets and liabilities should be defined in relation to economic resources and economic obligations and that revenues and expenses should reflect changes in those resources and obligations.
26. We note that some of the issues being raised today are the same as those raised by constituents when the FASB first sought feedback on the definitions of elements in the early 1970s. At that time some constituents expressed concern that if items that do not meet the definition of an asset are included in expenses of the current period, they may distort the income of other periods in which the items more properly belong. This issue is still being debated in the context of the GASB financial resources approach with outflows of resources that are intrinsically related to future services but which do not meet the definition of an asset being one of the items that may give rise to a deferred inflow.
27. We agree that it is important that financial statements provide information about such transactions, but we do not agree with the recognition of such items as deferred inflows and outflows. We believe that the most conceptually defensible approach is to develop robust definitions of assets and liabilities and then consider how to address any information needs that are not satisfied following application of those definitions, through perhaps presentation and disclosures.
28. Although the term 'asset and liability-led approach' has been used by a number of standard setters, we would like to stress that we do not consider that this approach is concerned predominantly with reporting financial position. We consider that revenues and expenses comprise the financial effects of an entity's current period accomplishments and that the 'asset and liability-led approach' gives equal importance to

the reporting of financial position (a “stock” concept) and financial performance (a “flows” concept). The two views simply reflect different perspectives on the financial effects of an entity’s current period accomplishments.

29. We are concerned with the focus of the ‘revenue and expense-led approach’ on achieving ‘inter-period equity’, and its adoption of the view that “the principle that taxpayers pay only for the services they receive and not pass on obligations to future taxpayers should ground any measure of financial performance”. Specifically, we are concerned that this approach is based on a value judgement about who should pay for services rendered in a particular period and a direct link between funding decisions and recognition of liabilities. We acknowledge that inter-period equity considerations are important for Governments and that financial statements may be used in making assessments of inter-period equity. However, this does not mean that inter-period equity should influence element definitions. Although entities need to consider how best to meet the information needs of general purpose financial statement users, we do not consider that user needs can be used as the basis of developing conceptual definitions.

**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?

30. In relation to specific matter for comment 12(a) we consider that transactions with residual/equity interests should be excluded from revenues and expenses. We support the view outlined in paragraph 4.41 of the CP that contributions intended to be an investment in the initial operating capacity of the entity or, subsequently to increase it, should be excluded from revenues. We also support the related treatment of distributions outlined in paragraph 4.41 (that is, distributions intended to reduce operating capacity or intended to be a return on the owners’ investment should be excluded from the definition of expenses). We consider that this approach is suitable for all types of public sector entities. We therefore refute the suggestion in paragraph 4.42 that this approach is appropriate only when net assets/liabilities are similar to a private sector equity interest.
31. In relation to specific matter for comment 12(b) we consider the definitions of revenue and expense should include inflows from all transactions and events other than transactions with residual/equity interests. We do not support limiting the definitions to specific types of activities associated with operations. Much of the current complexity in financial reporting revolves around the presentation of gains or losses in financial statements.
32. We consider that all gains and losses should be presented in a single comprehensive statement of financial performance. This removes the need to distinguish between revenue from operations and other revenue and removes the need for rules regarding classification of gains and losses. Our comments here are consistent with earlier comments to the IASB in relation to the presentation of financial statements. We have previously encouraged the IASB to remove the category of other comprehensive income as soon as solutions can be reached for items presently classified there.
33. 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.

**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?

34. We have not identified any other characteristics or issues.

**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?

35. Consistent with our response to specific matter for comment 11 we have not responded to this question. We do not support the identification of deferred outflows and deferred inflows.

**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 non-controlling 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?

36. In relation to specific matters for comment 15(a) and (b) we consider it essential that the proposed Framework acknowledge the existence of ownership interests in the public sector. In some cases there may be no identifiable ownership interest. For this reason we consider that net assets/net liabilities should be regarded as a residual amount. In many cases this residual will represent an ownership interest.

37. We support the approach set out in paragraph 5.25(a) of defining net assets/net liabilities and treating any specific ownership interest as a sub-classification of net assets.

**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?

38. In relation to specific matter for comment 16(a) we do not consider that residual/equity interests should be defined as separate elements. We disagree with the assertion in paragraph 5.33 that if a residual amount approach is taken to net asset/net liabilities that it would be inappropriate to separately identify and represent the existence of transactions that impact on that residual. We consider that a residual amount approach is the most appropriate because there will not be an identifiable ownership interest in every case. If a residual amount approach is adopted, we do not consider that this precludes acknowledgement of ownership interests. However, we do not consider that ownership interests should be defined as a separate element.

**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?

39. In relation to specific matter for comment 16(a) we support requiring a neutral judgment whether an element exists at the reporting date based on an assessment of all available evidence (as discussed in paragraphs 6.4 to 6.19 of the CP).
40. We note that, in the context of its Liabilities project, the IASB has considered the difficulties that can arise in applying this approach to events with uncertain outcomes such as lawsuits. The IASB has decided tentatively to specify that, in situations of uncertainty, existence of the obligation is met if the available evidence indicates that it is *more likely than not* that a liability exists. We note that although the IASB's Framework project will be informed by the thinking on this project, the IASB's decision has been made in the context of developing an IFRS rather than at the Framework level.
41. We consider that the Framework should provide guidance for the development of standards, and should not attempt to address standards-level issues. This is consistent with our view that the definitions of elements should be broad and that definitions and recognition criteria should be addressed separately.
42. Specific matter for comment 17(b) is not applicable based on our response to (a).

**Specific Matter for Comment 18**

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

43. We support the use of the same criteria for derecognition as for recognition. We acknowledge that development of standards level guidance for complex transactions can be challenging but see no reason why there should be any difference between recognition and derecognition in the Framework.

**Specific Matter for Comment 19**

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

44. We consider that recognition criteria should be separate and distinct requirements. Our comments on specific matters for comment 4 and 9 reflected our views on this matter.

**Other comments**

45. We recognise that this is a substantial project and that the IPSASB is working towards completion of a final Framework in May 2013. However, we would encourage the IPSASB to leave open the possibility of issuing an ED of the full Framework once all the separate phases have reached ED stage.