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Ms Stephenie Fox
The Technical Director
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CANADA

Dear Ms Fox

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

The Australian Accounting Standards Board (AASB) is pleased to provide its comments on the above named Consultation Paper (CP). In formulating its comments, the AASB considered the views received from Australian constituents.

The AASB supports the International Public Sector Accounting Standards Board's (IPSASB's) development of a conceptual framework for public sector entities as a high priority project. The AASB acknowledges that the development of the IPSASB's Conceptual Framework is not an IASB convergence project. However, the AASB supports the principle of transaction neutrality (because of, amongst other reasons, the benefits such a principle can bring to the quality of global financial reporting). It considers that the IPSASB's Conceptual Framework should differ from the revised IASB Conceptual Framework only when there is a public sector specific reason to do so. The AASB will find it difficult to incorporate aspects of an IPSASB Conceptual Framework into its own Framework to the extent differences exist without appropriate rationale. This is reflected in the AASB's comments in this submission.

The AASB supports the 'asset and liability-led approach' for identifying revenues and expenses. The AASB does not consider the 'revenue and expense-led approach' to be articulated clearly enough to enable proper comparison of the two approaches. Whilst the AASB supports an 'asset and liability-led approach', if the other approach were articulated more clearly, there would be an increased chance of identifying the conceptual differences between the approaches and reducing the risk of disagreements based on misunderstandings about what each approach entails.

The AASB suggests defining assets and liabilities generically, without requiring them to have an association with the entity. The AASB considers that it is useful to focus on the nature of economic phenomena (economic benefits and claims to economic benefits) that

affect various entities, without restricting definitions of assets and liabilities to only phenomena that affect the reporting entity. It considers that criteria for associating those particular phenomena with the reporting entity should be included in recognition criteria. This approach has the advantages of:

- (a) keeping the definitions relatively simple and readily understandable; and
- (b) helping minimise the risk that standard setters and others will ‘peek ahead’ to consider whether consequences of the definitions for the recognition of assets and liabilities will be desirable and/or consistent with existing conventions. Developing definitions that do not necessarily affect reporting entities should help in focusing on the economic phenomena to be identified as the elements of financial position (and, by derivation, the elements of financial performance).

In addition, the AASB recommends that assets and liabilities should not be limited to items that would necessarily be recognised in financial statements. Accordingly, a government’s rights/powers to tax and levy fees and social benefit obligations should be identified as assets and liabilities respectively, although these elements might not qualify for recognition in the financial statements.

The AASB’s responses to the specific matters for comment in the CP are set out in Appendix A.

Other AASB comments on the CP are set out in Appendix B.

If you have any queries regarding matters in this submission, please contact me or Mischa Ginns (mginns@aab.gov.au).

Yours sincerely,

Kevin Stevenson
Chairman and CEO

APPENDIX A

AASB's response to the Specific Matters for Comment on the CP

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?

The AASB supports a definition of an asset that covers all three types of benefits listed in Specific Matter for Comment 1(a).

In relation to Specific Matter for Comment 1(b), the AASB would prefer using the term 'economic benefits' in the definition of an asset, with clarifying guidance that service potential is a sub-set of economic benefits.

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?

As noted in the covering letter, the AASB considers that factors associating an element with an entity should be treated as recognition criteria rather than aspects of the element's definition.

In relation to Specific Matter for Comment 2(a), it may be difficult, in some circumstances, to associate an asset with an entity without considering the notion of control. Sometimes a resource is only a right (e.g., an amount receivable) and sometimes a resource is an object (e.g., owned property) that gives rise to various rights of its holder. This can cause different interpretations of 'rights' in relation to the identification of assets – for example, some argue that if a resource is a right, there is no obvious reason why it is preferable to say an entity has *access to that right* than to say an entity *controls that right*. In addition, if an asset is a right of access, using 'access to rights' would be confusing, because one would then say an entity has access to a right of access. Here, control would be more understandable. Therefore, the AASB supports an approach that includes either or both of the notions of control and access to rights, including the right to restrict or deny others'

access to rights. The AASB also considers that the risks and rewards notion may be a useful indicator of control and access to rights.

In relation to Specific Matter for Comment 2(b), the AASB considers that, depending on the nature of the item, either an enforceable claim to benefits or the ability to deny, restrict or otherwise regulate others' access would be necessary to link an asset with an entity. In this regard, the AASB agrees with the views in paragraphs 2.39 – 2.40 of the CP.

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?

The AASB considers that the identification of a past transaction or other past event should not be required in relation to assets, but a past transaction or other past event may be a useful indicator that an asset exists. This is because:

- (a) the AASB agrees with the arguments in paragraph 2.46 of the CP; and
- (b) in some circumstances, it is clear whether an asset presently exists, without needing to identify a past transaction or other past event.

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?

The AASB's view is that assets should be defined without limiting them to items that would necessarily be recognised in financial statements. Accordingly, a government's rights/powers to tax and levy fees should be identified as assets, although assets associated with a government's rights/powers to tax and levy fees might not qualify for recognition in the financial statements, until an event (such as the exercise of the rights/powers) occurs. The AASB does not support depicting a right to tax as a perpetual asset because it is potentially confusing to identify a separate category of assets. The AASB is of the view that the recognition criteria should be separate from definitions of the elements of financial statements, as noted in its comments on Specific Matter for Comment 19.

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?

The AASB has not identified any additional characteristics or other relevant issues. The AASB does however recommend that the definitions of assets and liabilities be symmetrical, or at least that asymmetry is explained.

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?

Consistent with its comments on Specific Matter for Comment 4, the AASB supports a broad definition of a liability, whilst noting that some types of liabilities may not meet the recognition criteria. A broad definition of a liability could lead to some of the broader obligations in the public sector, such as social benefit promises, being identified as liabilities.

In relation to Specific Matter for Comment 6(a), the AASB agrees that the types of obligations described in (a)(i) to (iv) are liabilities, to the extent that an entity has no realistic alternative to avoid an outflow of economic benefits in settlement of these types of obligations. The AASB considers unconditional obligations an essential characteristic of defining any liability, and not just an example of a liability. The AASB agrees with paragraph 3.11 of the CP and considers that:

- (a) an obligation cannot be realistically avoided if it is unconditional; and
- (b) treating conditional obligations as liabilities would broaden unacceptably the notion of a liability.

The AASB is concerned that (a)(iv) includes two types of obligations that should be considered separately.

In relation to Specific Matter for Comment 6(b), the AASB does not consider that a particular settlement date is an essential characteristic of a liability. Although a settlement date may be relevant in the context of a contract, it is not always relevant or essential. However, this should be contrasted with circumstances where an entity has complete discretion to settle an obligation at any time in the future. In those circumstances, it effectively can choose whether to settle the obligation, and therefore the obligation is not a liability.

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?

As noted in the covering letter, the AASB considers that factors associating an element with an entity should be treated as recognition criteria rather than aspects of the element's definition.

In relation to Specific Matter for Comment 7(a), the AASB is of the view that the definition of a liability should require an outflow of resources from which an entity cannot realistically withdraw, without including an essential characteristic for identifying a specific party(ies) outside the reporting entity to whom the entity is obligated.

In relation to Specific Matter for Comment 7(b), the AASB agrees that the absence of a realistic ability to withdraw from the obligation is an essential characteristic of a recognised liability.

In relation to Specific Matter for Comment 7(c):

- (a) the AASB considers that the definition of a liability should be applicable to all types of obligations, with no distinction between obligations arising from exchange and non-exchange transactions; and
- (b) the application of the 'cannot realistically withdraw' principle should be addressed in standards-level projects. Accordingly, the AASB does not have a view on whether any and, if so, which of the three approaches identified in paragraph 3.28 should be preferred at a conceptual level.

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?

Consistent with its comments on Specific Matter for Comment 3, the AASB does not consider a past event to be an essential component of the definition of a liability. However, a past event may be a useful indicator of when a present obligation exists.

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?

In relation to Specific Matter for Comment 9(a), the AASB:

- (a) considers that obligations to provide social benefits are liabilities that may qualify for recognition; but
- (b) does not support depicting such obligations as ‘perpetual obligations’ because doing so would seem likely to confuse the issue of which obligations are liabilities.

In relation to Specific Matter for Comment 9(b), the AASB is of the view that:

- (a) as noted in its comments on Specific Matter for Comment 7(b), the absence of a realistic ability to withdraw from the obligation is an essential characteristic of a recognised liability; and
- (b) the AASB considers that the issue of whether enforceability of an obligation is necessary for an inability to realistically withdraw should not be addressed at a conceptual level.

Factors associating a liability with an entity should be treated as recognition criteria rather than aspects of the definition of a liability.

With regard to Specific Matter for Comment 9(c), the AASB considers that sovereign powers should not be a basis for excluding some obligations from qualifying as recognised liabilities of an entity with those powers. This view applies equally to the concept of a recognised liability and to guidance on that concept. Consistent with the comment in the last sentence of paragraph 3.60 of the CP, the AASB considers that assessments of whether particular legal obligations meet the definition of a liability should be based on existing legislation.

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?

The AASB has not identified any additional characteristics that are essential to the development of the definition of a liability. Nor has it identified any other issues that need to be considered.

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?

The AASB is of the view that assets and liabilities should be defined in relation to economic resources and economic obligations, that revenues and expenses should reflect changes in those economic resources and economic obligations, and that (apart from net assets/equity) the statement of financial position should report only assets and liabilities. It therefore supports the ‘asset and liability-led approach’ for identifying the elements of the statement of financial position and for determining the amounts of revenues and expenses, and endorses the comments in paragraphs 4.24-4.25 of the CP. Assets and liabilities are economic phenomena that have a dimension that is external to the entity. Deferred outflows and deferred inflows do not possess that quality.

An important reason why the AASB does not support the ‘revenue and expense-led approach’ is because that approach mixes economic phenomena and accounting devices (‘deferred outflows’ and ‘deferred inflows’) as elements of the financial statements.

The AASB is concerned that the discussion in paragraphs 4.4, 4.6 and 4.22 of the CP about the ‘revenue and expense-led approach’ implies it is the only approach concerned with reporting current period financial performance. That approach defines revenues and expenses as “flows that relate to efforts of the current period” (paragraph 4.6). The logical implication is that the ‘asset and liability-led approach’ is concerned predominantly with reporting financial position, with reported financial performance being a by-product of that emphasis. However, the AASB considers 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 and financial performance.

The AASB is also 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 underlie any measure of financial performance” (paragraph 4.21). The AASB is particularly concerned that this approach is based on a value judgement about who should pay for services rendered in a particular period and its direct link between funding decisions and recognition. If a decision were made that taxpayers of a different period should pay for current period services, should the recognition principles change accordingly? The AASB thinks the accounting principles should not change, but is concerned that adopting the ‘inter-period equity concept’ may create a precedent for public policy decisions to determine recognition principles.

The AASB does not consider the ‘revenue and expense-led approach’ to be articulated clearly enough to enable proper comparison of the two approaches. Whilst the AASB supports an ‘asset and liability-led approach’, if the other approach were articulated more clearly, there would be an increased chance of identifying the conceptual differences between the approaches and reducing the risk of disagreements based on misunderstandings about what each approach entails.

The AASB notes that the main objectives of the ‘revenue and expense-led approach’ are described as:

- (a) attributing the costs of services to the period in which the services are provided; and
- (b) attributing tax and other revenue to the period in which they were intended to finance the related costs (paragraph 4.8).

However, the AASB notes other unrelated notions are implicit in the CP’s discussion of the ‘revenue and expense-led approach’. For example, a ‘likely realisation’ notion seems to be applied to the recognition of gains and losses on assets [paragraph 4.31(d)].

When inflows of resources are not stipulated to be used to finance particular costs of services, attributing those inflows to particular costs of services would involve arbitrary allocations. For example, inflows of resources from general purpose taxes and grants without stipulations can be applied to meet costs of current period services, repay debts incurred in providing services in previous periods or meet the costs of providing services in future periods. Because cash is fungible, any allocation of those inflows to particular outflows would be arbitrary and intent-driven. Another illustration of this concern is Example 1 in paragraphs 4.13 – 4.15 of the CP. Retention of the grant is conditional on construction of the library—that is, the inflow is required to finance an expenditure rather than an expense. However, under the revenue and expense-led approach, the grant revenue is recognised when the library is depreciated. Furthermore, it is unclear how the revenue and expense-led approach would be applied if a grant were stipulated as financing the purchase of a non-depreciable asset (e.g., land) or was in the form of ‘seed money’ for the acquisition of an asset that must be maintained and refurbished for an indefinite period. In these cases, would a deferred inflow be recognised indefinitely?

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?

In relation to Specific Matter for Comment 12(a), the AASB considers that transactions with residual/equity interests should be excluded from revenues and expenses.

In relation to Specific Matter for Comment 12(b), the AASB does not support restricting the definitions of revenue and expenses to specific types of activities associated with operations. Instead, the definitions of revenue and expense should include inflows from all transactions and events other than transactions with residual/equity interests.

The AASB considers that the desire of some to limit the definitions of revenue and expenses to specific types of entity activities or events has more to do with display of financial information about components of broadly defined revenues and expenses than with the breadth of the definitions per se. Accordingly, the AASB considers that this issue should be considered more fully by the IPSASB, within the context of broad definitions, when it develops further the Presentation and Disclosure phase of its Conceptual Framework project.

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?

The AASB has not identified any other characteristics that are essential to the development of the definitions of revenues and expenses. Nor has it identified any other issues that need to be considered.

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?

In relation to Specific Matter for Comment 14(a), the AASB does not consider it appropriate to identify deferrals in the statement of financial position, for the reasons noted in the AASB's comments to Specific Matter for Comment 11.

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?

In relation to Specific Matter for Comment 15(a), the AASB would prefer that net assets/net liabilities were described as a residual interest rather than a residual amount. The AASB does not support treating net assets/net liabilities as necessarily being an ownership

interest because, in some cases, there may not be an identifiable ownership interest in a public sector entity.

The AASB supports the approach set out in paragraph 5.25(a) of the CP that defines net assets/net liabilities and treats any specific ownership interest as a sub-classification of net assets/net liabilities.

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?

In relation to Specific Matter for Comment 16(a), the AASB is of the view that transactions with residual interest holders could, but do not need to, be defined as separate elements. However, it is important to define transactions with residual interest holders because they are part of existing definitions of revenues and expenses.

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?

The AASB is of the view that the recognition criteria should be:

- (a) separate from definitions of the elements of financial statements; and
- (b) neutral, both in requiring a neutral judgement of whether an element exists at the reporting date and in specifying the same recognition threshold for all assets and liabilities.

Specific Matter for Comment 18

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

The AASB supports the use of the same criteria for derecognition as for initial recognition. A corollary of the AASB's view that recognition criteria should be neutral is that recognition criteria should apply equally to the initial recognition and subsequent recognition of an element. Derecognition is synonymous with treating an element as failing criteria for subsequent recognition.

Another reason for using the same criteria for initial recognition and derecognition is the AASB's view that a past transaction or other past event should not be a pre-requisite for the identification of an asset or a liability (see comments on Specific Matters for Comment 3

and 8). Having different derecognition criteria to the criteria for initial recognition of an element implicitly requires a critical event for derecognition to occur. In contrast, if the same criteria apply to initial recognition and derecognition, determining whether an element is presently recognised is unaffected by whether it has previously been recognised, and therefore there is no need to consider whether a particular event has occurred.

Specific Matter for Comment 19

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

The AASB considers that recognition criteria should be separate and distinct requirements from the definitions of the elements of financial statements. This is consistent with the AASB's response to specific matters for comment 4 and 9.

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APPENDIX B

Other AASB Comments on the CP

Paragraphs	Comment
2.51(a)	The combination of ‘right’ and ‘power’ in this sentence is confusing. The AASB recommends the IPSASB to elaborate on the distinction.
2.53	The AASB suggests rewording the last sentence of paragraph 2.53 to say “as with any assets, they would be subject to recognition criteria to determine whether they are recognised in the financial statements” instead of saying that “these rights would still have measurement hurdles to overcome”.
General	The AASB acknowledges that this is a substantial project and that the IPSASB is working towards completion of a final Framework in May 2013. However, given the interrelationship of the various phases, it encourages the IPSASB to leave open the possibility of issuing an ED of the full Framework once EDs have been issued in respect of all phases of the project.