



## **Agenda Item 4A: Conceptual Framework: Elements**

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IPSASB Meeting

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## Objectives of session

1. To provide directions on:
  - Meaning of fin. performance & position for Conceptual Framework
  - Whether to identify deferred items as elements
2. Review and agree: proposed amendments to CF–ED2 re directions in June 2013 & issues identified by respondents to CF-ED2.

### Agenda Materials:

- 4A.1 Issues paper – financial performance, position, DI &DO
- 4A.2 Issues paper – Assets, Liabilities, Revenues, Expenses Ownership Contributions & Distributions
- 4A.3 Marked- up working draft CF–ED2
- 4A.4 Extract of draft minutes of June 2013

## 4A.1 Background: financial performance and position

### Framework Chapter 2 (Agenda item 4A.1 page 2, 3. Attachment 1)

- Fin performance and position provide info. about:
  - Resources of entity, claims to them, changes in them during the reporting period
  - Acquired and used resources effectively and efficiently
  - Amount and sources of cost recovery during period
  - Sustainability of service delivery over long term
- Financial performance not fully reflected in financial results
  - Assess in context of service delivery achievements, compliance with budgets, prospective financial information

# Background – financial performance and position

## Elements CP (Agenda item 4A.1 page 3, 4. Attachment 2)

### Two approaches to reporting fin. performance in fin. statements

1. Net result of changes in resources and obligations during the period (other than from ownership contributions & distributions); or
  2. Result of revenue & expense flows more closely associated with activities of reporting period:
    - Deferred inflows & outflows identified as elements of the St. of fin position
    - Deferred inflows (DI) & outflows (DO) excluded from revenue and expense
      - DI: an entity's increase or acquisition of net assets applicable to a future reporting period
      - DO: an entity's consumption or reduction of net assets applicable to a future reporting period
- Consult'n paper did not propose adoption of one or other – sought views
  - Responses to SMC not overwhelmingly in support of one or other

# Background – financial performance and position

## Exposure Draft CF-ED2 (Agenda item 4A.1 page 4, 5)

### Approach to financial performance:

- Result of revenue & expense flows more closely associated with activities of reporting period:
  - **Deferred Inflow:** inflow of assets for use in specified future reporting period from a non-exchange transaction and increases net assets (para 5.1)
  - **Deferred Outflow:** outflow of assets to another entity for use in a specified future reporting period from a non-exchange transaction that decreases net assets (para 5.2)
  - Revenue= increase in net assets – Ownership Contrib'n–increase in DI + decrease in DI (para 4.1)
  - Expense= decrease in net assets– Ownership Distribn–increase in DO+decrease in DO (para 4.2)

# Background – financial performance and position

## CF-ED2 (Agenda item 4A.1 page 5)

CF-ED 2:            Surplus (deficit) = revenue – expenses  
                         Net Assets = Assets - Liabilities  
                         Net financial position= net assets + DO – DI

- Surplus or deficit for the period is the primary indicator of fin. performance. (Para4.7)
- Positive net financial position represents the net resources available for providing goods or services in future periods. (Para BC47)
- Negative net financial position indicates that insufficient revenues have been generated at the reporting date to meet the expenses of the entity in the provision of services. (Para BC47)

## Background – financial performance and position

### Responses to CF-ED2 (Agenda item 4A.1 page 6, 7)

- Respondents that support:
  - financial performance of period best represented by:
    - extent to which costs of period activities were funded by revenues generated for, or available for use during, that period
    - identification of deferred inflows and outflows as separate elements, which will ensure transparency and consistency in presentation
- Major concerns of respondents that opposed:
  - Identifies elements that do not represent economic resources and obligations
  - Not consistent with widely adopted accounting framework – IASB, GFS,
  - Increases complexity and subjectivity
  - Too narrow a view of primary measure of financial performance
  - DI & DO deal only with non-exchange transactions & time period specified

## Background – financial performance and position

Alternative Views (AV1 & AV 2) CF-ED2 (Agenda item 4A.1 page 7, 10)

Some respondents express support for Alternate Views 1 and/or 2

AV 1: Change in net assets = revenue – expense (not exclude  $\uparrow\downarrow$  in DI & DO)

Net financial position = net assets + DO – DI

- Change in net assets and surplus/deficit are both relevant performance indicators (Para AV5)
- Net financial position is not the primary indicator of net resources available for provision of services in the future (Para AV 6)



# Background – financial performance and position

Alternative Views (AV1 and AV 2) in CF-ED2 (Agenda item 4A.1 page 7, 10)

AV 2: Surplus (deficit) = revenue – expense (not exclude  $\uparrow\downarrow$  in DI & DO)

Net assets = assets – liabilities (Does not present Net Financial Position)

- DI & DO not recognized as elements but included in revenue & expense (para AV 8)
  - Revenue when entity gains control of a resource (other than an ownership contribution)
  - Expense when entity loses control of resources (other than ownership distribution)
- This more appropriately demonstrates resources for which entity is accountable (AV 9)
- Presentation & disclosure at standards level provide relevant info. about DI & DO (AV 11)

# Analysis - financial performance & position in Exposure Draft – CF-ED2

Simple examples to test notions of financial performance and position presented by CF-ED2 and Alternative Views

- Period financial performance
- Resources available to provide services in future
- Establish principles that apply in all circumstances

## **Analysis - financial performance & position in exposure Draft – CF-ED2 – additional factors**

As IPSASB considers decision on DI and DO as elements:

- Consider if necessary to specify:
  - The financial statements that will recognise each element
  - That only one of the measures of financial performance will be presented
- Preferable to establish “in-principle” definitions of deferred resources & obligations to respond to some concerns

## Examples – CF-ED 2 and Alternative Views

### Example 1 (Agenda item 4A.1 page 11-25)

- 1 - Receipt of time stipulated resources (Fig. 1-3. p.12) (ED para 5.3)
- 2(a) Activity does not occur in specified time period (Fig. 4-6 p15)
  - ED para 5.5
- 2(b) Time period for usage of grant is not specified (Fig. 7-9 p18)
  - ED para 5.1
- 3 – Grant of Non-monetary assets received for use over a specified period (Fig. 10-12, p21) (ED para 5.3)
- Transferor - Transfer of time stipulated resources (Fig.13-15, p24)  
(ED para 5.4) (Correction: delete last line figure 15)

# Financial performance and financial position

(Agenda item 4A.1 page 26)

- **IPSASB DIRECTIONS**
  - FINANCIAL PERFORMANCE AND FINANCIAL POSITION
    - Reaction to meaning as reflected in examples
    - Implications for CF – ED2 approach, and moving forward to final chapter

# Financial performance and financial position

(Agenda item 4A.1 page 26)

*Staff View: As per June 2013*

- *...because of the complexity and subjectivity associated with the application of separate elements, inflows and outflows of service potential or economic benefits related to specified future reporting periods might be best addressed through presentational approaches.*
- However, many respondents acknowledge that information about revenues and expenses associated with period activities is important.

## Analysis - financial performance & position in CF-ED2 – Additional matters to consider (Agenda item 4A.1 page 26-27)

Is it necessary to specify:

- The financial statements that will recognise each element (resp. 29)
  - Suite/contents of financial statements can develop/change.
- That only one of the measures of financial performance will be presented
  - Framework could acknowledge that both are important measures of financial performance for presentation in GPFRs
  - This Chapter of Framework identify elements but not specify presentation
  - Move away from formulaic definition of revenue and expense

Presentation alternatives can be developed at standards level

- **IPSASB DIRECTIONS**

- “Disengage” elements from specific financial statements?

## Analysis - financial performance & position in CF-ED2 – The case for deferrals as elements: (Agenda item 4A.1 page 27-28)

Some inflows are subject to performance obligation that  $\neq$  liability of recipient

- In effect, anticipates or requires the entity to act or perform in a particular way
- They are in nature of “deferred obligation” - to recognize as liability or revenue
  - “taints” liability
  - “taints” revenue under period approach to financial performance

Some outflows impose a form of obligation on recipient but  $\neq$  asset of transferor

- In effect, aiding transferor to achieve its objectives in a future period
- They are in nature of prepayment or “deferred resource” - to recognize as asset or expense
  - “taints” asset
  - “taints” expense under period approach to financial performance

Case for them to be identified as elements on an “in-principle” basis.

Leave anti-abuse measures/refinements to standards level

(Correction: quote page 28 from respondent 6)



## Analysis - financial performance & position in CF-ED2 – Additional matters to consider (Agenda item 4A.1 page 27-28)

“In-principle” definitions of deferred resources & obligations (Consultation Paper approach).

- *Deferred resources*: an entity’s consumption or reduction of net assets that is applicable to a future reporting period;
- *Deferred obligations*: an entity’s increase or acquisition of net assets that is applicable to a future reporting period
- **IPSASB DIRECTIONS**
  - Deferred resources and deferred obligations as elements?
  - In principle definition?

## Analysis - financial performance & position in CF-ED2 – matters for clarification (Agenda item 4A.1 page 29-30)

If IPSASB retains CF-ED2 approach, clarify/strengthened some explanation:

- Terminology use/explain “stipulations” - (drawn from IPSAS 23)
  - See 4A.3 para 5.3 footnote, 5.4 & paras BC 35, 40, 46 (*timing or external restrictions* )
- BC 40 explains DI and DO included as element in St. financial position.

Useful to Note IPSASB also considered deferred items as elements of St. of financial performance

- See 4A.3 para BC43 *boxed text*
- Explanation of negative net financial position
  - Acknowledge relationship to net assets and long run performance (4A.3 para 47)
  - (Responds (6,11,16, 23, 28,29) clarify relationship to, and meaning of, net assets)

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### • IPSASB DIRECTIONS

## **Analysis - financial performance & position in exposure draft – CF-ED2**

- END OF AGENDA ITEM 4A.1
- AGENDA ITEM 4A.2 COMMENCES

## SMC 1: Definition of an asset – decisions in June 2013 + Agenda item 4A.2 page 1-2

- Control para 2.6 (b) – respondents concerns that control not linked to:
  - Benefits to the entity (8, 38). Benefits to constituents re services provided (12, 15, 31)
  - See 4A.3 boxed text following para 2.6
- Definition of asset para 2.1- Relationship b/w a resource & asset (18, 36)
  - Restructure 2.1 & 2.2. Characteristics of resource and characteristics to qualify as asset
  - See 4A.3 marked up text 2.1, 2.2, 3.13, BC 24
- Definition of asset para 2.1 – inflows of service potential
  - June 2013, IPSASB agree definition not include “future”, BC explain inflows ↑ op capacity
    - See 4A.3 marked up para BC 3
  - *Inflows of service potential & eco. benefits* implies a future resource (responses 12, 25, 31)
  - “Inflows” not used in text. Propose deletion of inflows – see 4A.3 para 2.2

### • IPSASB DIRECTIONS

## SMC 1: Definition of an asset – decisions June 2013 + (Agenda item 4A.2 page 3-4)

- Indicators of Control para 2.7: (resp:31 &39) proposed add risks & rewards to list
  - June 2013, IPSASB decided not to add to indicators of control & explain reasons in BC
  - See 4A.3 boxed text following BC 16
- Unconditional rights - concern with explanation in BC 6 (resp: 3, 39)
  - Redraft BC 6 to confirm satisfy definition & recognition criteria to qualify for recognition
  - Acq'n in exchange, traded/valued in active market likely to satisfy recognition criteria
  - See 4A.3 boxed text after BC 6
- Executory Contracts – concern with para BC 7 (resp: 3, 31, 37)
  - Framework establishes principles, rather than defer decision to standards level
  - Refocus para BC7 to note deal with presentation issues to satisfy QCs at standards level
  - See 4A.3 marked up text in BC 7

### – IPSASB DIRECTIONS

## SMC 2 (a) & (b): Definition of a liability – decisions June + (Agenda item 4A.2 page 4-5)

- Definition of liability para 3.1
- Relationship b/w present obligation & liability
  - Restructure 3.2. Characteristics of present obligation: *legal or non-legal binding obligation* and then conditions for present obligation to satisfy definition of liability
  - Terminology “other binding obligation” rather than “non-legal”
    - See 4A.3 boxed text after 3.2 – consequential amendments to be processed
- Remove “little or” no realistic alternative to avoid
  - Agenda item 4A.3: mark-up 3.2 and consequentials. Explanation in boxed text @ BC29
  - **BUT** does it have desired effect?
- June 2013 IPSASB decision to add reference to political coercion
  - see agenda item 4A.3 para 3.7

### – IPSASB DIRECTIONS

## SMC 2 (a) & (b): Definition of a liability – decisions June + (Agenda item 4A.2 page 5-6)

- Conditional & unconditional obligations and stand ready obligations
  - Respondents (3,14, 29, 31,37,38,39) concern with explanation in BC 22 and 24 re:
    - *Distinguishing between conditional & unconditional obligations not useful*
    - *Stand ready obligation not “work well” in public sector because unintended assumptions about recognition of social benefits -deal with social benefits at standards level*
  - IPSASB decided retain BC22 & BC 24, but explain public sector context more fully
  - Agenda item 4A.3 boxed text following para BC 22 & BC 24
    - IASB DP – stand ready obligations meet, & conditional obligations can meet, definition of liability
    - IASB not yet decided how narrowly to define conditional obligations that meet definition of liability
- Commitments – Respondents (6, 35) concerned that no reference in CF-ED 2
  - Agenda item 4A.3 boxed text following para BC 33

## SMC 3&4: Definitions of revenue and expenses

(Agenda item 4A.2 page 7, 8 – from June 2013)

- Analysis of responses considered at June 2013 meeting:
  - Revenue -10 agreed; 6 partially agreed; 22 disagreed
  - Expenses -11 agreed; 4 partially agreed; 23 disagreed
  - Many disagreed due to deferred inflows/deferred outflows
- A number of proposals for clarification - staff view standards level issues
  - Identify triggering event for recognition of revenue and expense
  - Separate presentation of operating and capital revenue & expense
- Other proposals for change not supported by staff
  - Terminology change to gains & loss, income rather than revenue
  - Include reference to sovereign revenue
  - Remove reference to ownership contributions and distributions from definitions
    - IPSASB agreed June 2013 not remove OC & OD

### • IPSASB DIRECTIONS



## SMC 3&4: Definitions of revenue and expenses

(Agenda item 4A.2 page 7, 8. from June 2013)

- Definition of revenue & expenses encompass all changes in eco. resources
  - Staff initial reaction to support (respondents 3,12, 39 support.19 not support) but:
    - Test against notion of financial performance
    - Consider consequential changes re para 4.7 re description of surplus
    - Consider implications of following paras in CF-ED2:
      - Specification that revenue & expense in St. of financial performance (para 1.2)
      - Revenue expense include all changes in net assets other than OC, OD, DI, DO (para 4.5)
- **IPSASB DIRECTIONS**
- CF-ED2 (Para 4.7): Fuller explanation of fin. performance & role of DI & DO
  - Review 4.7. BC 40-43 in light of decisions at this meeting.
  - In context as chapter of Framework acknowledge link to Chapter 2 in BC
  - Propose: TBG staff develop for review next meeting

# SMC 3&4: Definitions of revenue and expenses

(Agenda item 4A.2 page 9)

- Revenues & expenses from fee for service and subsidized activities
  - Revenue and expenses arise from increases and decreases in net assets.
    - Full cost recovery “*fee for service*” and fully subsidized activities will not  $\uparrow\downarrow$  net assets
    - BC 36 deals with sale of inventory but could also note other “*public sector*” circumstances
    - Staff proposal at Agenda item 4A.3 marked-up para BC 36

- **IPSASB DIRECTIONS**

## SMC 6: Net assets, net fin. position, ownership contrib'ns & distrib'ns (Agenda item 4A.2 page 9, 10. From June 2013)

### 6 (a): Terms/descriptions of net assets & net financial position

- 10 agreed;12 partially agreed;16 disagreed
  - Most opposition to net financial position b/c of opposition to DI & DO
  - Concerns with explanation of net financial position
    - Some concerns noted in Agenda item 4A.1 with proposed staff response
    - Also concern about potential confusion with “net financial worth” in GFS
      - Staff propose build into explanation around para BC 47 if appropriate
- 
- **IPSASB DIRECTIONS**

## SMC 6 (b): ownership contributions & ownership distributions (Agenda item 4A.2 page 10, 11. From June 2013)

June 2013, IPSASB agreed:

- Ownership contributions & distributions are elements of fin. Statements
- Clarify treatment of transfers between pub. sector entities in para 6.5 (resp 39)
- Agenda item 4A.3, marked up text para 6.5 and BC 50 (...but is sentence necessary)
  
- Concern with OC & OD as elements of St. of fin position, (5, 8,12,24, 39)
  - OC & OD defined as inflows and outflows rather than “stocks”
  - St. of changes in net assets/equity deal with ownership contributions & distributions in current suite of statements in IPSAS 1.
  - Staff propose not linking OC&OD to a specific statement
    - See agenda item 4A.3 marked up paras 1.2 and 6.2

### • IPSASB DIRECTIONS

## SMC 7: Recognition

(Agenda item 4A.2 page 11. From June 2013)

- At June 2013 meeting IPSASB agreed that BC should:
  - Acknowledge thresholds re existence uncertainty may be included in standards
  - Include legal case as example of measurement uncertainty
  - Para 7.5 should acknowledge all QCs not just relevance & faithful representation
- See Agenda item 4A.3 paras 7.5 & BC 54 and boxed text after BC 57

- **IPSASB DIRECTIONS**

# Terminology and next steps

(Agenda item 4A.2 page 12)

- Terminology – Staff propose that final chapter refer to:
  - “reporting period” rather than “year”
  - “services” rather than goods and services.
  - These have been marked up in 4A.3
- At next meeting prepare first draft of Chapter
  - Consider additional issues identified by respondents
    - Clarify meaning of inflow/outflow in definitions of revenue and expense
    - Clarify meaning of net assets and relationship to net financial position
    - Tighten definition of OC and OD

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