XRB | Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Board Meeting Agenda

In-person meeting, Wellington — Tuesday, 12 December 2023

Est Time	Item	Topic	Objective		Page
NON-PUBLIC SESSION					
PUBLIC SESSION					
11.30 am	**4**	**PBE Conceptual Framework Update**	(GS)		
50 min	4.1	Board memo	Consider	Paper	2
	4.2	IPSASB Conceptual Framework – Chapter 3 *Qualitative Characteristics*	Consider	Paper	33
	4.3	IPSASB Conceptual Framework – Chapter 5 *Elements in Financial Statements*	Consider	Paper	56
12.20 pm	**5**	**Lack of exchangeability – RDR concessions**	(AS)		
10 min	5.1	Board memo	Consider	Paper	96
	5.2	Draft amending standard	Approve	Paper	99
	5.3	Draft signing memo	Approve	Paper	107
12.30 pm 40 min	**Lunch**				
NON-PUBLIC SESSION					
PUBLIC SESSION					
1.40 pm	**7**	**IPSAS 49 *Retirement Benefit Plans***	(CB)		
15 min	7.1	Board memo – application of the PBE Policy Approach	Consider	Paper	110
	7.2	IPSAS 49 *Retirement Benefit Plans*	Consider	Paper	115
NON-PUBLIC SESSION					
3.55 pm	*Finish*				

Next NZASB meeting: 15 February 2024, in person Wellington

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Memorandum

Date:	5 December 2023
To:	NZASB Members
From:	Gali Slyuzberg
Subject:	**PBE Conceptual Framework Limited Scope Update**

COVER SHEET

Project priority and complexity

Project priority	**Medium** • While the PBE Conceptual Framework is not a standard, it plays an important role in the development of PBE Standards, and preparers of financial statements refer to the Conceptual Framework when a matter is not specifically addressed by standards. • There are areas of interrelation between the updated definitions of assets and liabilities and the PBE Revenue and Transfer Expenses projects. • The IPSASB's updates to its Conceptual Framework are limited in scope, but they relate to key concepts underpinning financial statements.
Complexity of Board decision-making at this meeting	**Medium** The Board is being asked to agree to develop an Exposure Draft (ED) proposing the incorporation of the IPSASB's updates to Chapters 3 and 5 of its Conceptual Framework into the PBE Conceptual Framework – and to agree on potential New Zealand modifications in the ED.

Overview of agenda item

Project status	Development of ED proposing to incorporate the IPSASB's updates to two of its Conceptual Framework chapters: Chapter 3 *Qualitative Characteristics and* Chapter 5 *Elements in Financial Statements*.
Project purpose	Consistent with our PBE Policy Approach, to align the PBE Conceptual Framework with the updated IPSASB Conceptual Framework – which is in turn aligned with the latest international thinking from the IASB on certain conceptual matters and addresses matters encountered by the IPSASB in using the Conceptual Framework in standard setting.
Board action required at this meeting	AGREE to develop an ED proposing to incorporate the IPSASB's updates to Chapters 3 and 5 into the PBE Conceptual Framework, and agree on New Zealand modifications. We will ask for Board feedback on the questions raised in this memo. We encourage any editorial comments to be sent directly to staff - gali.slyuzberg@xrb.govt.nz

Purpose and introduction[1]

1. In October 2023, the IPSASB finalised its project *Conceptual Framework – Limited Scope Updates*, by issuing amendments to the following chapters of its Conceptual Framework:

   (a) Chapter 3 *Qualitative Characteristics* (issued in October 2023); and

   (b) Chapter 5 *Elements in Financial Statements* (issued in May 2023).

2. The IPSASB's amendments clarify the role of prudence and expand the guidance on materiality, as well as update the definitions of assets and liabilities and related guidance. Many of the amendments are aligned with the IASB's 2018 Conceptual Framework updates.

3. The purpose of this memo is to seek the Board's agreement to develop an Exposure Draft (ED) proposing to incorporate the IPSASB's updates to Chapters 3 and 5 of its Conceptual Framework into the PBE Conceptual Framework – and to agree on New Zealand modifications.

4. Please note: This memo does not cover the IPSASB's Conceptual Framework amendments to Chapter 7 on Measurement. The Board agreed to defer the application of the PBE Policy Approach to the IPSASB's recent pronouncements arising from its Measurement project – including the updates to Chapter 7 of the Conceptual Framework – until once the IPSASB finalises 'Phase 2' of its Measurement project, which is currently ongoing.

Recommendations

5. We recommend that the Board:

   (a) APPLIES the PBE Policy Approach to the IPSASB's amendments to Chapters 3 and 5 of its Conceptual Framework;

   (b) AGREES to develop proposed amendments to the PBE Conceptual Framework using the IPSASB's amendments as a starting point; and

   (c) AGREES on New Zealand modifications to the IPSASB's amendments.

Structure of this memo

6. This memo includes the following sections.

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[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

Background

7. In February 2022, the IPSASB issued ED 81 *Conceptual Framework Update: Chapter 3, Qualitative Characteristics and Chapter 5, Elements in Financial Statements*.

8. The ED proposed limited-scope updates to the IPSASB Conceptual Framework. The proposals arose from the following developments since the IPSASB Framework was approved in 2014:

   (a) the IPSASB's experience in applying the Framework to the development and maintenance of IPSAS; and

   (b) developments in international thinking about conceptual issues – specifically, the IASB's updates to its Conceptual Framework in 2018.

9. In summary, the ED proposed amendments to the following chapters:

   (a) Chapter 3 *Qualitative Characteristics*: Amendments to clarify the role of prudence and update the guidance on materiality.

   (b) Chapter 5 *Elements in Financial Statements*: Revised definition of a liability that refers to 'transfer of resources', amendments to the description of a 'resource' in the context of the definition of an asset, amendments to the related guidance on assets and liabilities, and new guidance on the 'unit of account' and on 'binding arrangements that are equally unperformed' ('executory contracts').

10. The Board submitted a comment letter on IPSASB ED 81 in May 2022. The letter was broadly supportive of the ED proposals, but included some recommended improvements. The IPSASB addressed some, but not all of our recommendations (see the 'NZ modifications' section of this memo).

11. The IPSASB issued the finalised amendments to Chapter 5 in May 2023, and the finalised amendments to Chapter 3 were issued in October 2023. Therefore, at this meeting, we are asking the Board to consider the development of amendments to the PBE Conceptual Framework as a result of the IPSASB's amendments.

Overview of the IPSASB amendments

12. The IPSASB's amendments to Chapters 3 and 5 are summarised below. Both of the updated chapters (as issued by the IPSASB) are attached as Agenda Items 4.2 and 4.3 respectively.

Table 1 Summary of IPSASB amendments to Conceptual Framework Chapter 3

Amendments to Chapter 3	Ref
Prudence The amendments clarify the role of prudence in supporting neutrality, which is an aspect of faithful representation. The amendments note the following. • Prudence is the exercise of caution when making judgements under conditions of uncertainty. Exercising prudence means that assets, liabilities, revenue, and expenses are not overstated or understated.	Para 3.14A – 3.14B

Amendments to Chapter 3	Ref
• The exercise of prudence does not imply a need for asymmetry (e.g. systematically requiring more evidence for recognising assets or revenue as compared to liabilities and expenses). However, some standards may include asymmetric requirements. These amendments are aligned with the IASB's Conceptual Framework.	
Materiality The amendments update the guidance on materiality by adding a reference to the *obscuring* of information. That is, information is material if omitting, misstating *or obscuring* it could be reasonably expected to influence the discharge of accountability by the entity or the decisions made by users of the financial statements. This amendment is aligned with the IASB's Conceptual Framework.	Para 3.32–3.33A

Table 2 Summary of IPSASB amendments to Conceptual Framework Chapter 5

Amendments to Chapter 5	Ref
Definition of an asset and related guidance: <u>Rights-based approach to description of 'resource'</u> The IPSASB amended the description of a 'resource' – which is an element of the definition of an asset – and the related guidance. Specifically, the IPSASB adopted a rights-based approach to the description of a resource – similarly to the IASB Conceptual Framework. The IPSASB Conceptual Framework previously described a resource as "an *item* with service potential or the ability to generate economic benefits". The related guidance referred to benefits arising *either from the resource itself, or from rights to use it*. However, the IPSASB agreed with the IASB's argument that the guidance on assets *should not distinguish between benefits* that arise from *owning an object* and those that arise from the *right to use an object*. This is because rights conferred by legal ownership of an object and rights to use the object for some of its useful life are *both types of rights* – not separate phenomena. The new description of a resource in Chapter 5 is: "*a right to either service potential or the capability to generate economic benefits, or a right to both*". Most of the added guidance on rights is based on the guidance in the IASB's Conceptual Framework. However, unlike the IASB, the IPSASB has had to refer both to economic benefits and service potential in its proposed description of a resource and the related guidance. <u>Minor amendment to the definition of an asset</u> In the definition of a liability, the IPSASB replaced the reference to past event (singular) with 'past events' (plural) – given that an asset may arise from a single past event or multiple past events. This amendment is aligned with the IASB's Conceptual Framework.	Para 5.6–5.13

Amendments to Chapter 5	Ref
Definition of a liability and related guidance <ins>Reference to 'transfer of resources'</ins> The IPSASB updated the definition of a liability, so that it refers to the present obligation to *transfer resources* – rather than a present obligation for an outflow of resources. Specifically, the definition of a liability was updated as follows: *"A present obligation of the entity ~~for an outflow~~ <ins>to transfer</ins> ~~of~~ resources <ins>as a result of</ins> ~~that results~~ ~~from~~ ~~a~~ past event<ins>s."</ins>* In 2018, the IASB made a similar amendment to the definition of a liability in its Conceptual Framework. The previously used term 'outflow of [economic] resources' was linked to guidance on *expected* outflow of resources. The IASB considered that this focus on expectation of outflow conflates the requirements for meeting the *definition* of a liability with the requirements for the *recognition* of a liability. Therefore, in the IASB's Conceptual Framework, the IASB replaced the notion of expected outflow of resources with the notion of potential to require transfer of resources. The IPSASB found this argument persuasive. The IPSASB also amended the guidance on the definition of a liability, based on the IASB's guidance in its Conceptual Framework – with modifications to reflect the public sector context. The amendments to the guidance on the definition of a liability include new guidance on the concept of 'transfer of resources'. The IPSASB considered this guidance to be particularly important in the context of the new IPSASs on *Revenue* and *Transfer Expenses*, which have a focus on liabilities arising from binding arrangements. The amendments also emphasise that the *definition* of a liability can be met *even when the probability of a transfer/outflow of resources is low*. These amendments are consistent with the guidance on the definition of a liability in the IASB's Conceptual Framework as amended in 2018. However, the IASB had also enhanced the guidance on the *recognition* of assets and liabilities in its Conceptual Framework, whereas the IPSASB did not enhance the recognition guidance in its Conceptual Framework, which remains relatively limited. *We have a concern in this regard – please see the discussion on New Zealand modifications*. <ins>Minor amendment to the definition of a liability</ins> As with the definition of an asset, the IPSASB proposes to refer to 'past events' (plural), rather than a 'past event', in the definition of a liability. <ins>Reorganisation of the section on liabilities</ins> The ED proposes to rearrange the section on liabilities in Chapter 5, so that the order of topics discussed in the guidance are aligned with the proposed new definition of a liability.	Para 5.14 – 5.26
Unit of account The 'unit of account' is the unit to which recognition criteria and measurement concepts are applied. Currently, there is no specific guidance on the 'unit of account' in the IPSASB Conceptual Framework. The IPSASB added into Chapter 5 a new section on the 'unit of account'. The new guidance is largely based on the equivalent guidance in the IASB's Conceptual Framework.	Para 5.26A–5.26H

Amendments to Chapter 5	Ref
Binding arrangements that are equally unperformed (executory contracts) The IPSASB added new guidance on the unit of account includes guidance on 'binding arrangements that are equally unperformed'. This guidance is based on the IASB's guidance on executory contracts in its Conceptual Framework. However, the IPSASB decided not to use the term 'executory contracts', because in some jurisdictions the term 'contract' is problematic in the public sector.	Para 5.26I–5.26J

Application of the PBE Policy Approach

13. The Board's approach to developing and enhancing the suite of PBE Standards is set out in the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach).

14. The PBE Policy Approach generally refers to adding or amending *standards* within the PBE Standards suite – but the PBE Conceptual Framework is an authoritative notice, rather than a standard.

15. However, we understand that the 'development principle' in the PBE Policy Approach is also suitable for considering whether to make changes to the PBE Conceptual Framework. Like PBE Standards, the PBE Conceptual Framework is primarily based on the IPSASB Conceptual Framework. The factors of the development principle in the PBE Conceptual Framework, including considering whether a development would lead to higher quality financial reporting, and considering coherence with the suite of PBE Standards, seem to also be relevant to considering changes to the PBE Conceptual Framework – particularly given that one of the roles of the PBE Conceptual Framework is to assist preparers of general purpose financial reports, e.g. in developing consistent accounting policies for topics that are not specifically addressed by PBE Standards or when there is an accounting policy choice (see paragraph 1.1.1(c) of the PBE Conceptual Framework).

16. We consider that the following parts of the PBE Policy Approach relating to the publication of a new IPSAS are relevant to considering changes to the PBE Conceptual Framework as a result of changes to the IPSASB Conceptual Framework:

    (a) The PBE Policy Approach identifies triggers for making changes to PBE Standards. One of these triggers is the IPSASB issuing a new or amended IPSAS. Section 4.1 (paragraphs 22–24) of the PBE Policy Approach establishes a rebuttable presumption that the Board will adopt a new or amended IPSAS.

    (b) The PBE Policy Approach states that it is expected that the adoption of a new or amended IPSAS will lead to higher quality financial reporting by public benefit entities (PBEs) in New Zealand, and the factors in the 'development principle' set out on the PBE Policy Approach are presumed to be met.

17. The table below lists the factors of the development principle in the PBE Policy approach, and our analysis regarding the IPSASB's updates to Chapter 3 and 5 of its Conceptual Framework.

Table 3: Factors in the Development Principle – PBE Policy Approach

Factors in the Development Principle	Comment
Whether the potential development will lead to higher quality financial reporting by public sector PBEs and not-for-profit entities, including public sector PBE groups and not-for-profit groups, than would be the case if the development was not made.	**Yes - albeit we recommend some modifications** The IPSASB's amendments would bring into the PBE Conceptual Framework some of the useful amendments that the IASB introduced into its own Conceptual Framework. For example. • The IPSASB updated the guidance on materiality in Chapter 3, so that it refers to *not obscuring* information – and we heard feedback from the TRG in 2022 that this guidance would be useful. • In Chapter 5, the rights-based approach to the description of a resource in the context of the definition of an asset arguably provides a means of applying the definition of an asset more consistently, rather than distinguishing between benefits/service potential that arise from ownership of an item vs benefits/service potential that arise from rights to use an item. Furthermore, the IPSASB's new guidance in Chapter 5 on the concept of 'unit of account' and 'binding arrangements that are equally unperformed' (executory contracts) – based on the equivalent IASB guidance – would close what could be considered as 'gaps' in the PBE Conceptual Framework. This would help preparers in considering these topics when using the Conceptual Framework in conjunction with individual PBE Standards. However, we have a concern that adding the new paragraphs in IPSASB's Chapter 5 that emphasise that the definition of a liability can be met even when the probability of a transfer of resources is low – without also adding the IASB's enhanced guidance on the recognition of liabilities – could cause confusion when determining whether a liability with a low probability of resource transfer/outflow should be recognised. Therefore, we propose New Zealand modifications in this regard – see the next section of this memo.

<table>
<tr><th>Factors in the Development Principle</th><th>Comment</th></tr>
<tr><td>Whether the benefits of a potential development will outweigh the costs, considering as a minimum:
(i) relevance to the PBE sector as a whole: for example, where the potential development arises from the issue of a new or amended IFRS, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;
(ii) relevance to the not-for-profit or public sector sub-sectors: whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;
(iii) coherence: the impact on the entire suite of PBE Standards (e.g., can the change be adopted without destroying the coherence of the suite);
(iv) the impact on mixed groups.</td><td>As noted above, we think that the IPSASB's amendments would introduce into the PBE Conceptual Framework some useful updates from the IASB's 2018 amendments to its Conceptual Framework – and these would be useful to preparers of financial statements, given that preparers refer to the Conceptual Framework in conjunction with PBE Standards when a transaction is not specifically covered by a standard or in deciding between several possible accounting treatments, etc.
Furthermore, the IPSASB considered that the development of the guidance on 'transfer of resources' in Chapter 5 is important for underpinning the requirements in its new standards on Revenue and Transfer Expenses. As the Board agreed to commence the development of new PBE Standards using the IPSASB's Revenue and Transfer Expenses standards as starting points, it is arguably important to update the PBE Conceptual Framework for the new guidance on 'transfer of resources' in the context of a liability. However, as noted above, we have a concern about some of the updates to the IPSASB's guidance on the definition of a liability, and we recommend New Zealand modifications in this regard, by adding in the enhanced guidance on the recognition of liabilities from the IASB's Conceptual Framework (see the next section of this memo).</td></tr>
<tr><td>In the case of a potential development arising from the issue of a new or amended IFRS, the IPSASB's likely response to the change (e.g., whether the IPSASB is expected to develop an IPSAS on the topic in an acceptable time frame).</td><td>N/A – in this case, the 'trigger' for applying the PBE Policy Approach is an IPSASB pronouncement, rather than an IASB pronouncement (although we recommend supplementing the IPSASB's amendments with some enhancements that the IASB made to its Conceptual Framework – see the next section).</td></tr>
</table>

18. Based on the analysis above, we recommend that the Board agrees to propose amendments to the PBE Conceptual Framework, using the IPSASB's amendments to Chapters 3 and 5 of its Conceptual Framework as starting points – albeit with New Zealand modifications, as explained in the next section of this memo.

Question for the Board

Q1. Does the Board agree to commence a project to develop proposed amendments to the PBE Conceptual Framework, using the amendments to Chapter 3 and Chapter 5 of the IPSASB Conceptual Framework as starting points?

New Zealand modifications

19. If the Board agrees to incorporate the IPSASB's amendments to Chapters 3 and 5 of its Conceptual Framework into the PBE Conceptual Framework, we recommend to also incorporate into the PBE Conceptual Framework the enhanced guidance on the recognition of liabilities (and assets) from the IASB's Conceptual Framework. This is in response to a concern that we have about the new IPSASB paragraphs in Chapter 5 that emphasise that the definition of a liability can be met even if the probability of a transfer of resources is low. More information is provided below.

20. We are interested in the Board's views on whether we should make New Zealand modifications with respect to any other points raised in the Board's comment letter on IPSASB ED 81 that the IPSASB had not addressed. At this stage, we have not recommended New Zealand modifications with respect to those other points.

21. In addition, when drafting the relevant PBE ED, we will replace the IPSASB's references to 'public sector entities' with 'public benefit entities', add references to 'not-for-profit entities' where needed, and make similar amendments for New Zealand terminology and context.

Modifications due to references to 'low probability' in the IPSASB guidance on liabilities

Description of the issue

22. This section refers to specific aspects of the updated guidance on the definition of liabilities in Chapter 5 of the IPSASB's Conceptual Framework. For ease of reference, Appendix A of this memo includes the full 'liabilities' section from the IPSASB's updated Chapter 5 – excluding any of the other IPSASB updates to Chapter 5.

23. The IPSASB updated the definition of a liability in its Conceptual Framework as shown below. *"A present obligation of the entity ~~for an outflow~~ to transfer ~~of~~ resources as a result of ~~that results from a~~ past events."*

24. This change is aligned with changes made by the IASB to its Conceptual Framework in 2018 – for the reasons explained in the section 'Overview of the IPSASB Amendments' (see Table 2).

25. We do not have specific concerns about the change from 'outflow of resources' to 'transfer of resources' in the IPSASB's definition of a liability. However, we have some concerns about the updated guidance that accompanies this definition in the IPSASB's updated Chapter 5.

26. We note that the updated guidance on the definition of a liability emphasises that an obligation may meet the definition of a liability even if the probability of having to transfer resources is low. For example, this is the case in new paragraphs 5.16A and 5.16B.

   - 5.16: A To satisfy the definition of a liability the obligation must have the potential to require the entity to transfer resources to another party (or parties). For that potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer resources—the transfer may, for example, be required only if a specified uncertain future event occurs. It is only necessary that the present obligation exists, and that, at least in one circumstance, it would require the entity to transfer resources.

- 5.16B: An obligation can meet the definition of a liability even if the probability of a transfer of resources is low. Nevertheless, that low probability might affect decisions about the information provided about the liability and how the information is provided. Chapter 6 provides guidance on recognition and Chapter 7 provides guidance on measurement.

27. We appreciate that the intent behind the new paragraphs above is to avoid conflating the *definition* of a liability with the *recognition* criteria (and measurement requirements) for liabilities – and we also acknowledge that the above paragraphs are aligned with the IASB's Conceptual Framework as updated in 2018.

28. However, we note that in updating its Conceptual Framework in 2018, the IASB updated not only the guidance on the definition of a liability, but also the guidance on *recognition*. The guidance on the recognition of liabilities in the IASB's Conceptual Framework seems to be more detailed and robust than the guidance on the recognition of liabilities in the IPSASB Conceptual Framework. That is:

    (a) In the IPSASB's Conceptual Framework, Chapter 6 *Recognition in Financial Statements* includes some references to considering the qualitative characteristics and considering uncertainty. The chapter says that the recognition criteria are that "an item satisfies the definition of an element; and can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs". The chapter also says that uncertainty in relation to existence of an 'element' needs to be considered when considering recognition, and uncertainty over the amount of service potential needs to be considered as part of the measurement of the element. However, Chapter 6 does not go beyond this guidance. Chapter 6 is included in full in Appendix B of this memo.

    (b) By contrast, the chapter on recognition in the IASB's Conceptual Framework (Chapter 5) includes specific sections on considering relevance and faithful representation when determining whether a liability (or an asset) is recognised. These sections include a specific discussion on low probability of outflow (and inflow) of economic resources, as well as a discussion on existence uncertainty and measurement uncertainty (the IASB's guidance on recognition criteria is included in Appendix C of this memo). This detailed guidance is not included in the IPSASB's Conceptual Framework.

29. In the Board's comment letter to the IPSASB on ED 81, we recommended that the IPSASB consider enhancing the guidance on the recognition of liabilities (and assets) in its Conceptual Framework in a similar vein to the IASB's Conceptual Framework – to help clarify that when the likelihood of a transfer of resources is low, an item may meet the definition of a liability but might not meet the criteria for recognition.

30. However, the IPSASB did not amend the recognition guidance in Chapter 6. We are concerned that the lack of enhancement to the recognition guidance, coupled with the introduction of new paragraphs emphasising that obligations with low probability of resource transfer can still meet the definition of a liability, may lead to lack of clarity as to whether obligations with low probability of resource transfer should be recognised in the financial statements. This could possibly lead to obligations where the probability of resource transfer is very low being

recognised in the statement of financial position – which may negatively affect the usefulness of PBE financial statements and result in different to recognition outcomes compared to for-profit entities. Also, even if such liabilities are measured at low amounts due to uncertainties around transfer of resources, entities would still need to spend time and incur costs on measuring these liabilities.

31. In considering the above concern, we acknowledge that the IPSASB's Chapter 5 includes guidance on the necessity to have a *present* obligation, which is *binding*, and which the entity has 'little or no realistic alternative to avoid', for the definition of a liability to be met. For example:

    (a) Paragraph 5.17 says: "A present obligation is binding. To satisfy the definition of a liability, it is necessary that a present obligation arises as a result of one or more past transactions or other past events and has the potential to require the entity to transfer resources from the entity".

    (b) Paragraph 5.17B says that "in the public sector, obligations may arise at a number of points". It then provides examples of points at which an obligation may arise "in implementing a program or service" – these points include: "making a political promise such as an electoral pledge; announcement of a policy; introduction (and approval) of the budget (which may be two distinct points); and the budget becoming effective". The paragraph goes on to say "The early stages of implementation are unlikely to give rise to present obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to present obligations that meet the definition of a liability. As noted in paragraph 5.15A an entity cannot be obligated to itself as a result of a public communication".

    (c) Paragraph 5.17C says: "The point at which an obligation gives rise to a liability depends on the nature of the obligation. Factors that are likely to impact on judgments whether other parties can validly conclude that the obligation is such that the entity has little or no realistic alternative to avoid a transfer an outflow of resources include […]".

32. The above paragraph could be read as limiting the impact of paragraph 5.16A and 5.16B. However, they could also be read as being at odds with paragraphs 5.16A and 5.16B, which could lead to lack of clarity for those using the Conceptual Framework. Enhanced recognition guidance such as the one included in the IASB's Conceptual Framework could possibly mitigate this risk when it comes to determining whether to recognise a liability with low probability of transfer of resources.

33. We note that when the IPSASB discussed our recommendation to enhance the guidance on recognition of assets and liabilities (see paragraph 29 above) before finalising the updated Chapter 5, IPSASB staff noted the following in the IPSASB December 2022 Agenda Item 10.2.2:

    "Recognition was not within scope of the Limited Scope project and the IPSASB did not consult on amendments to Chapter 6, *Recognition in Financial Statements*. Paragraph 5.16B states that 'An obligation can meet the definition of a liability even if the probability of a transfer of resources is low.' It qualifies this statement by acknowledging that 'Nevertheless, that low probability might affect decisions about what information to provide about the liability and how to provide that information.' This guidance establishes a key principle but allows specific requirements and guidance to be developed at the standards-level".

34. Based on the above, we understand that the IPSASB expects *individual IPSAS* to be clear on whether liabilities with low probability of resource transfer should be recognised or not – and as such, enhancements to the recognition chapter in the IPSASB's Conceptual Framework is not required in this regard.

35. Therefore, in the section that follows, we have considered the liability recognition requirements in an IPSAS-based draft PBE ED and two IPSAS-based PBE Standards – and whether any issues might arise from the updated Chapter 5 of the IPSASB's Conceptual Framework in the context of these requirements.

36. We acknowledge the IPSASB Conceptual Framework and the PBE Conceptual Framework do not override the requirements in IPSAS and PBE Standards respectively. However, we understand that preparers and/or their accounting advisers may sometimes refer to the Conceptual Framework in conjunction with considering the requirements in Standards – for example, when attempting to interpret the requirements of a Standard or when a specific transaction is not explicitly covered by the requirements of a Standard, etc.

Consideration of liability recognition requirements in individual IPSAS

Draft ED PBE IPSAS 47 *Revenue*

37. We are in the process of developing an ED for a PBE Standard based on IPSAS 47 *Revenue*, which was recently issued by the IPSASB.

38. IPSAS 47 distinguishes between two types of revenue transactions: transactions with binding arrangements, and transactions without binding arrangements. A 'binding arrangement' is defined as "an arrangement that confers both rights and obligations, enforceable through legal or equivalent means, on the parties to the arrangement".

39. The table below outlines the key requirements in IPSAS 47 for the recognition of liabilities for revenue transactions with and without binding arrangements.

Table 4: Key requirements for the recognition of liabilities in IPSAS 47

Transactions without a binding arrangement
26. An entity may have an obligation associated with the inflow of resources as a result of entering into a revenue transaction without a binding arrangement. The obligation meets the definition of a liability when it is a present obligation of the entity to transfer resources as a result of past events. 27. For a liability to exist, it is necessary that the entity cannot avoid a transfer of resources as a consequence of past events, and that the transfer of resources is probable. An entity should consider the facts and circumstances relating to the revenue transaction to determine if the obligation is enforceable and requires an incremental transfer of resources if the entity does not satisfy its obligation(s). 28. An obligation that meets the definition of a liability shall be recognised as a liability when, and only when, the amount of the obligation can be measured reliably.

Transaction with a binding arrangement
81. […] When an entity recognises an asset for an inflow of resources, it shall consider if there are compliance obligations related to the inflow which result in the recognition of a liability. 82. A compliance obligation gives rise to a liability when: (a) The entity has received resources associated with its unsatisfied or partially unsatisfied compliance obligation in a binding arrangement; and (b) The resource provider can enforce the binding arrangement, if the entity does not satisfy the compliance obligation(s) associated with the consideration received, by requiring the entity to transfer resources to another party in compliance with the terms of the binding arrangement. 83. […] a liability exists if the entity cannot avoid a transfer of resources as a consequence of past events, and the transfer of resources is probable. An entity should consider the facts and circumstances relating to the binding arrangement to determine if the other party or parties (which is typically the resource provider) are able to enforce their rights and impose a consequence that requires an incremental transfer of resources as a result of the entity's non-compliance (i.e., not satisfying its compliance obligation(s)). 85. If an entity receives resources prior to both the parties agreeing to the terms of the arrangement and it is expected that a binding arrangement will be entered into, it recognizes a liability for an advance receipt until such time as the arrangement becomes binding. 86. A compliance obligation that meets the definition of a liability shall be recognized as a liability when, and only when the amount of the obligation can be measured reliably.

40. The requirements in IPSAS 47 for both transactions with binding arrangements and transactions without binding arrangements require a liability to be recognised only when it is probable that a transfer of resources will occur and cannot be avoided (and the amount of the obligation can be measured reliably). On one hand, these requirements appear to make it clear that under this Standard, obligations where there is low probability of a transfer of resources are not to be recognised as liabilities.

41. However, it is possible that the new paragraphs 5.16A and 5.16B in Chapter 5 of the IPSASB's Conceptual Framework mentioned in the previous section of this memo could still cause confusion for preparers as to whether a liability should be recognised with respect to resources received in a revenue transaction – particularly if there is a lack of clarity around the consequences of non-compliance, and/or in other situations when a preparer may look to the Conceptual Framework to assist with the application of the Revenue standard.

42. For example, the abovementioned risk can be relevant when an entity receives funds to be used for 'internal purposes', e.g. to cover specific costs that the entity incurs as part of its operations, or for use in the entity's operations in general. In such cases, the existence of 'consequences' for non-performance of compliance obligations would be central to determining whether there is an obligation that gives rise to a transfer of resources, and whether this obligation should be recognised as a liability. However, unlike PBE IPSAS 23 *Revenue from Non-Exchange Transactions*, where the requirements for recognising a liability focus on 'use or return' conditions, the concept of 'consequences' in IPSAS 47 is not necessarily limited to 'use or return' – and we have been finding it challenging to determine the scope of 'consequences' that would give rise to the recognition of a liability. Therefore, a

preparer may look to the Conceptual Framework in conjunction with the requirements of IPSAS 47 when determining whether a liability should be recognised with respect to revenue received for 'internal purposes' – but without enhanced guidance on recognition in the IPSASB Conceptual Framework, the new paragraphs 5.16A and 5.16B in the Framework may possibly add to the lack of clarity, rather than resolving it.

PBE IPSAS 19 *Provisions, Contingent Assets and Contingent Liabilities*

43. PBE IPSAS 19 includes specific requirements and guidance on the recognition of provisions – which are liabilities of uncertain timing or amount. The following paragraphs in PBE IPSAS 19 specifically require that a provision be recognised only if it is probable that an outflow of resources will be required:

Table 5: Extract from the recognition requirements in PBE IPSAS 19

Paragraph 22: "A provision shall be recognised when: (a) An entity has a present obligation (legal or constructive) as a result of a past event; (b) It is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and (c) A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."
Paragraph 31: "For a liability to qualify for recognition, there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits or service potential to settle that obligation. For the purpose of this Standard, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, that is, the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote […].

44. While PBE IPSAS 19 makes it clear that the probability of an outflow of resources must be more likely than not for a provision liability to be recognised, the updates to Chapter 5 of the IPSASB Conceptual Framework may possibly still cause confusion when preparers consider the Conceptual Framework in conjunction with the requirements of PBE IPSAS 19.

PBE IPSAS 41 *Financial Instruments* (financial liabilities)

45. The recognition-related requirements in PBE IPSAS 41 for financial liabilities (and assets) are relatively limited. These requirements focus on whether the entity has become a party to the contractual provisions of the instrument, as summarised below.

Table 6: Key recognition requirements for financial liabilities (and assets) in PBE IPSAS 41

Paragraph 10: "An entity shall recognise a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes party to the contractual provisions of the instrument […]"

> Paragraph AG16: The following are examples of applying the principle in paragraph 10:
>
> (a) Unconditional receivables and payables are recognised as assets or liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash.
>
> (b) Assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognised until at least one of the parties has performed under the agreement. For example, an entity that receives a firm order does not generally recognise an asset (and the entity that places the order does not recognise a liability) at the time of the commitment but, instead, delays recognition until the ordered goods or services have been shipped, delivered or rendered. […]
>
> (c) A forward contract that is within the scope of this Standard […] is recognised as an asset or a liability on the commitment date, instead of on the date on which settlement takes place. […] If the net fair value of the right and obligation is not zero, the contract is recognised as an asset or liability.
>
> (d) Option contracts that are within the scope of this Standard [...] are recognised as assets or liabilities when the holder or writer becomes a party to the contract.
>
> (e) Planned future transactions, no matter how likely, are not assets and liabilities because the entity has not become a party to a contract.

46. It should also be noted that the definition of 'financial liability' in PBE IPSAS 28 *Financial Instruments: Presentation* refers to "a contractual obligation to deliver cash or another financial asset to another entity" – and PBE IPSAS 28 explains the following about contractual obligations:

    "In this Standard, 'contract' and 'contractual' refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law.

47. While PBE IPSAS 28 refers to having little if any discretion to avoid the obligation to deliver cash or another financial asset, etc., there does not seem to be much specific guidance in that Standard or PBE IPSAS 41 in relation to the probability of outflows and how this affect recognition. It may be possible that the updates to Chapter 5 in the IPSASB Conceptual Framework in relation to low probability of transfer of resources may affect the recognition of financial liabilities – for example, in situations where there is uncertainty around the timing of becoming a party to the contractual provisions of an instruments, and the preparer may be using the Conceptual Framework in conjunction with PBE IPSAS 41 and PBE IPSAS 28 to determine whether a liability should be recognised.

Discussion with the TRG

48. We have discussed the IPSASB's updates to the guidance on the definition of a liability with the Accounting Technical Reference Group (TRG) in November 2023. An external guest from the public sector also attended this discussion. More information on this TRG discussion is included in Agenda Item 2.6.

49. The TRG meeting attendees broadly agreed with our concern. The following points were noted during the TRG discussion:

    (a) While individual PBE Standards such as PBE IPSAS 19 require outflow of resources to be probable for a liability to be recognised, it would be unhelpful if the PBE Conceptual Framework indicated something different – which could be the case if the new IPSASB paragraphs emphasising that the definition of a liability can be met even when the probability of the outflow of resources is low are added into the PBE Conceptual Framework, without enhancing the guidance on the recognition of liabilities.

    (b) Furthermore, updating the Conceptual Framework in line with the IASB's guidance on the *definition* of a liability without also updating the Conceptual Framework for the IASB's enhanced guidance on the *recognition* of liabilities could indicate to stakeholders that the IPSASB intended for the recognition of liabilities to be different under IPSAS as compared to IFRS Accounting Standards – and by extension, that the recognition of liabilities should work differently for PBEs as compared to for-profit entities – which we understand is generally not the case.

50. The recommendation arising from the TRG discussion was to add the enhanced guidance on the recognition of liabilities (and assets) from the IASB's Conceptual Framework into the PBE Conceptual Framework, together with the IPSASB's updates.

Staff recommendations

51. Based on our analysis above and the TRG discussion on this topic, we recommend that the New Zealand ED that includes the IPSASB's updates to Chapters 3 and 5 also includes the enhanced guidance on the *recognition* of assets and liabilities from *Chapter 5 of the IASB Conceptual Framework* (see Appendix C of this memo).

52. This means that in addition to proposals to amend Chapters 3 and 5 of the PBE Conceptual Framework, the New Zealand ED would also propose updates to Chapter 6 of the PBE Conceptual Framework, *Recognition in Financial Statements.* (Chapter 6 in its current form is attached as Appendix B).

53. In developing the proposals to enhance the recognition guidance in Chapter 6 of the PBE Conceptual Framework, we will need to check that the IASB-based text that we are adding fits coherently within the existing text in this chapter. This may involve replacing some of the existing text in Chapter 6 with IASB-based text, or excluding some IASB-based text that is already mentioned in Chapter 6. We will also bear in mind that where the IASB text refers to economic benefit, we may need to add references to 'service potential' to reflect the PBE context. We plan to bring a draft ED to the next Board meeting (see the 'next steps' section).

Question for the Board

Q2. Does the Board agree with staff's recommendations to incorporate the enhanced guidance on *recognition* in the *IASB's Conceptual Framework* into the New Zealand PBE ED that would include the IPSASB's updates to Conceptual Framework Chapters 3 and 5?

Consideration of other matters raised in the Board's comment letter on IPSASB ED 81

54. The table below lists the recommendations that were included in the Board's comment letter on IPSAS ED 81, other than the matter mentioned in the previous section. The table notes whether the IPSASB addressed our recommendations, and our considerations on whether to develop New Zealand modifications in relation to these topics.

Table 7 Other matters raised in the NZASB's comment letter on IPSASB ED 81

Matter raised in NZASB comment letter	IPSASB addressed?	Do we recommend NZ modification?
Chapter 3 Qualitative Characteristics		
[1] Materiality – display and disclosure: IPSASB ED 81 included the following proposed sentence: "Where an entity judges that a material item is not separately displayed on the face of a financial statement (or displayed sufficiently prominently) an entity considers disclosure". We recommended not to include this sentence in the Conceptual Framework, because we were not convinced that it is necessary to discuss this specific matter within the general guidance on materiality, and the wording of the sentence seemed unclear.	Yes	N/A – the proposed sentence was excluded from the finalised Chapter 3
[2] Materiality – obscuring information: While we supported the IPSASB's reference to not obscuring material information, we recommend further clarifying what is meant by 'obscuring information'. The clarification could explain that if financial statements include excessive amounts of detailed information, this could negatively affect a user's ability to find the information that the user needs to be able to make decisions, or to confirm that the entity has discharged its accountability. Therefore, for financial statements to provide useful information to users, it is important to ensure that material information is not obscured by immaterial information.	No	**On balance, no.** We note that the IASB does not provide the additional details that we recommended about 'obscuring information' in the materiality paragraph in its Conceptual Framework. However, the IASB's 2018 amendments *Definition of Material* amended IAS 1 by providing further details on 'obscuring information' in the context of materiality – including an explanation that information is 'obscured' when "the understandability of the financial statements is reduced as a result of material information being hidden by immaterial information to the extent that a primary user is unable to determine what information is material". The IPSASB plans to consider amendments to IPSAS based on the IASB's *Definition of Material* in its

Matter raised in NZASB comment letter	IPSASB addressed?	Do we recommend NZ modification?
		next round of *Improvements to IPSAS* (2024). If the IPSASB amends IPSAS 1 in line with the IASB's amendments, this could help address the point we raised in the comment letter. We will continue to monitor the IPSASB's project.
Chapter 5 Elements in Financial Statements		
[3] Definition of an asset – streamlining the definition: The IPSASB's updated description of a resource is: "A right to either service potential or the capability to generate economic benefits, or a right to both". We noted that the IASB's description of a resource is: "a right that has the potential to produce economic benefits". Considering the IASB's description of a resource, we recommended further simplifying/streamlining this description as follows, to enhance the understandability of the description: "A resource is a *right that has the capability to generate* economic benefits or service potential or both."	**No**	**On balance, no.** While we still consider that our proposed wording for the description of a resource is more streamlined and would enhance readability, we think that the IPSASB's description is sufficiently understandable – and given that the description of a resource is a key part of a key conceptual definition (the definition of an asset) in the PBE Conceptual Framework, we consider that aligning with the international public sector description of a resource (i.e. the IPSASB's one) is important.
[4] Definition of an asset and definition of a liability – replacement of 'past event' with 'past events': We heard concerns from the TRG that this amendment in the definition of an asset/ liability may imply that a single event is no longer sufficient to give rise to an asset/ liability. We recommended clarifying further that the term 'past events' cover situations where an asset or liability arises from a single past event or multiple past events.	**No**	**On balance, no.** While the IPSASB's finalised definitions of assets and liabilities still refer to 'past events', we note that the relevant paragraphs providing guidance on the elements of these definitions refer to 'one or more' past events (see paragraphs 5.13, 5.14A(c) in Chapter 5). We think that on balance, this would be sufficient to address the concerns mentioned by the TRG at the ED stage.

Matter raised in NZASB comment letter	IPSASB addressed?	Do we recommend NZ modification?
[5] Definition of a liability – references to public communication of intentions: We noted that paragraphs 5.15A and 5.17C both refer to public communication of intentions in the context of a liability – and there is a possible inconsistency between these references: (a) Paragraph 5.15A states that an obligation must be to an external party to give rise to a liability, and an entity "cannot be obligated to itself, *even where it has publicly communicated an intention to behave in a particular way*". (b) Paragraph 5.17C then discusses the point at which a liability arises. This paragraph states that a promise made in an election is unlikely to give rise to a present obligation that meets the definition of a liability, but an announcement might have "such political support that the government has little option to withdraw". This implies that public communication could give rise to a liability – and there is no qualification in this paragraph that the liability must be to an external party. Therefore, this paragraph could be read as being inconsistent with what paragraph 5.15A says about public communication of intentions. We acknowledged that paragraph 5.15A and 5.17C discuss public communication of intentions in different contexts. However, to address the perceived inconsistency, we recommended deleting the reference to public communication from paragraph 5.15A.	**No**	**On balance, no.** On balance, we think that the different contexts in which public communication of intention is discussed in paragraphs 5.15A and 5.17C may be sufficient to avoid confusion regarding the possible inconsistency that we described in the comment letter.

Matter raised in NZASB comment letter	IPSASB addressed?	Do we recommend NZ modification?
[6] Definition of a liability – clarifying amendment to paragraph 5.17C: The relocated paragraph 5.17C lists factors that are likely to impact judgement around the point at which a liability arises. The factor discussed in the second bullet point of paragraph 5.17C is the entity's ability to modify or change the obligation before it crystalises. The last sentence in this bullet point is marked for deletion. The deleted sentence says: "Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before these events occur". A NZ stakeholder recommended clarifying in the Basis for Conclusions (BC) why that sentence was deleted. We assumed the deletion was in order to avoid conflict with the new paragraph 5.16A, which says that to meet the definition of a liability, the obligation must have the potential to require the outflow of resources, but the outflow need not be likely and may depend on an unspecified future event.	**Yes**	**N/A** – the IPSASB explained in the BC (paragraph BC5.19E) why the sentence about contingent future events and discretion to avoid an outflow of resources was deleted from paragraph 5.17C. The explanation is consistent with our expectation, i.e. to avoid conflict with the new paragraph 5.16A – see the explanation in the left-hand column. (Our concerns regarding new paragraph 5.16A and 5.16B and related recommendations are covered in the previous section of this memo.)
[7] Binding arrangements that are equally unperformed: In the ED, the proposed guidance on binding arrangements that are equally unperformed was included in the 'unit of account' section – but this guidance does not relate solely to determining the unit of account. Therefore, we recommended including this guidance in a separate section (like the IASB did) – or else to explain more clearly the decision not to do so.	**Yes**	**N/A** – in finalising Chapter 5, the IPSASB moved the new guidance on 'binding arrangements that are equally unperformed' into a separate section, so that it is no longer within the 'unit of account' section.

55. On balance, we do not recommend New Zealand modifications based on the matters listed in Table 6 above – but we welcome Board Members' feedback on whether further modifications are needed.

Question for the Board
Q3. Does the Board prefer staff to develop any other New Zealand modifications in addition to the one discussed under Question 2 above?

Next steps

56. If the Board agrees with staff recommendations, staff will draft an ED proposing to incorporate the IPSASB's amendments to Chapters 3 and 5 of its Conceptual Framework into the PBE Conceptual Framework, together with New Zealand modifications as described above.

57. We plan to bring the draft ED and accompanying Consultation Document to the Board's February 2024 meeting, to seek the Board's approval of these documents.

58. We are still considering the optimal timing for consulting on this ED. Given the linkages between the amendments to Chapter 5 of the Conceptual Framework and the PBE Revenue project, it may be beneficial to consult on the updates to the PBE Conceptual Framework at the same time as consulting on the PBE Revenue and Transfer Expenses EDs. On the other hand, it may be useful for the Conceptual Framework updates to already be in place ahead of the New Zealand consultation on Revenue and Transfer Expenses. We will keep considering this further, and we welcome any suggestions from Board Members.

Attachments

Agenda item 4.2: IPSASB Conceptual Framework – Chapter 3 *Qualitative Characteristics*

Agenda item 4.3: IPSASB Conceptual Framework – Chapter 5 *Elements in Financial Statements*

Appendix A: Liabilities section in the updated Chapter 5 of the IPSASB Conceptual Framework

This is an extract from the updated Chapter 5 of the IPSASB's Conceptual Framework, as issued by the IPSASB in May 2023 – showing the amendments made by the IPSASB. Text added by the IPSASB is underlined, text deleted by IPSASB is struck through, and existing text that has been relocated from different paragraphs is double-underlined. Please note that these marked-up amendments are not yet included in the PBE Conceptual Framework – the NZASB will be considering whether to do so in the near future.

Liabilities

Definition

5.14 A liability is:

A present obligation of the entity ~~for an outflow~~ to transfer ~~of~~ resources as a result of ~~that results~~ ~~from~~ ~~a~~ past events.

5.14A For a liability to exist, three criteria must all be satisfied:

(a) The entity has an obligation (paragraphs 5.15-5.15F);

(b) The obligation is to transfer resources (paragraphs 5.16A-5.16F); and

(c) The obligation is a present obligation arising from one or more past events (paragraphs 5.17-5.17D).

~~A Present~~ Obligations

5.15 Public sector entities can have a number of obligations. Obligations are binding when an entity has little or no realistic alternative to avoid them. ~~A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources~~.

~~Legal and Non-Legally Binding Obligations~~

5.15A Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations can arise from both exchange and non-exchange transactions. An obligation must be to an external party in order to give rise to a liability. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Identification of an external party is an indication of the existence of an obligation giving rise to a liability. However, it is not essential to know the identity of the external party before the time of settlement in order for ~~a present~~ an obligation and a liability to exist.

5.15B Many arrangements that give rise to an obligation include settlement dates. The inclusion of a settlement date may provide an indication that an obligation involves ~~an outflow~~ a transfer of resources and gives rise to a liability. However, there are many agreements that do not contain settlement dates. The absence of a settlement date does not preclude an obligation giving rise to a liability.

Legal Obligations

5.15C A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent authority or arrangements. There are jurisdictions where government and public sector entities cannot enter into legal obligations, because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in the Conceptual Framework. For some types of non-exchange transactions, judgment will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law, there can be no doubt that an entity has little or no realistic alternative to avoid the obligation and that a liability exists.

5.15D Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date, but will be enforceable with the passage of time without the external party having to meet further conditions— or having to take any further action—prior to settlement. Claims that are unconditionally enforceable subject to the passage of time are enforceable obligations in the context of the definition of a liability.

5.15E Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this Conceptual Framework. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.

Non-Legally Binding Obligations

5.15F. Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give rise to liabilities have the following attributes:

- The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
- As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
- The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

~~An Outflow of Resources~~ A Transfer of Resources from the Entity

5.16 ~~A liability must involve an outflow of resources from the entity for it to be settled. An obligation that can be settled without an outflow of resources from the entity is not a liability.~~ [Deleted]

5.16A To satisfy the definition of a liability the obligation must have the potential to require the entity to transfer resources to another party (or parties). For that potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer resources—the transfer may, for example, be required only if a specified uncertain future event occurs. It is only necessary that the present obligation exists, and that, at least in one circumstance, it would require the entity to transfer resources.

5.16B An obligation can meet the definition of a liability even if the probability of a transfer of resources is low. Nevertheless, that low probability might affect decisions about the information provided about the liability and how the information is provided. Chapter 6 provides guidance on recognition and Chapter 7 provides guidance on measurement.

5.16C Obligations to transfer resources include, for example:

(a) Obligations to pay cash;

(b) Obligations to provide services or deliver goods;

(c) Obligations to exchange resources with another party on unfavorable terms. Such obligations include, for example, a forward contract to sell on terms that are currently unfavorable or an option that entitles another party to purchase resources from the entity;

(d) Obligations to transfer resources if a specified uncertain future event occurs; and

(e) Obligations to issue a financial instrument if that financial instrument will oblige the entity to transfer a resource.

5.16D Instead of fulfilling an obligation to transfer resources to the party that has a right to receive resources, entities may in some circumstances:

(a) Settle the obligation by negotiating a release from the obligation;

(b) Transfer the obligation to a third party; or

(c) Replace the obligation to transfer resources with another obligation by entering into a new transaction.

5.16E In the situations identified in paragraph 5.16D an entity has an obligation to transfer resources until it has settled, transferred, or replaced that obligation.

5.16F In a principal-agent relationship (see paragraph 5.12A)[2], if the agent has an obligation to transfer resources controlled by the principal to a third party, that obligation is not a liability of the agent. In such a case the resources that would be transferred are the principal's resources.

Present Obligation as a Result of Past Events

5.17 A present obligation is binding. To satisfy the definition of a liability, it is necessary that a present obligation arises as a result of one or more ~~a~~ past transactions ~~and~~ or other past events and has the potential to require the entity to ~~an outflow of resources~~ transfer resources from the entity. ~~The complexity of public sector programs and activities means that a number of events in the development, implementation and operation of a particular program may give rise to obligations. For financial reporting purposes it is necessary to determine whether such commitments and obligations, including binding obligations that the entity has little or no realistic alternative to avoid but are not legally enforceable (non-legally binding obligations) are present obligations and satisfy the definition of a liability. Where an arrangement has a legal form and is binding, such as a contract, the past event may be straightforward to identify. In other cases, it may be more difficult to identify the past event and identification involves an assessment of when an entity has little or no realistic alternative to avoid an outflow of resources from the entity. In making such an assessment an entity takes jurisdictional factors into account.~~

5.17A A present obligation exists as a result of past events only if:

(a) The entity has already obtained service potential or economic benefits or taken an action[3]; and

[2] [Para 5.12A: "Sometimes one party (a principal) engages another party (an agent) to act on behalf of, and for the benefit of, the principal[…] If an agent has custody of a resource controlled by the principal, that resource is not an asset of the agent".]

[3] In the public sector a present obligation can arise from an obligation imposed by a higher level of government.

(b) As a consequence, the entity will or may have to transfer resources that it would not otherwise have had to transfer.

5.17B In the public sector, obligations may arise at a number of points. For example, in implementing a program or service:

- Making a political promise such as an electoral pledge;
- Announcement of a policy;
- Introduction (and approval) of the budget (which may be two distinct points); and
- The budget becoming effective (in some jurisdictions the budget will not be effective until an appropriation has been effected).

The early stages of implementation are unlikely to give rise to present obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to present obligations that meet the definition of a liability. As noted in paragraph 5.15A an entity cannot be obligated to itself as a result of a public communication.

5.17C The point at which an obligation gives rise to a liability depends on the nature of the obligation. Factors that are likely to impact on judgments whether other parties can validly conclude that the obligation is such that the entity has little or no realistic alternative to avoid a transfer ~~an outflow~~ of resources include:

- The nature of the past event or events that give rise to the obligation. For example, a promise made in an election is unlikely to give rise to a present obligation because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it has little or no realistic alternative to avoid settling. However, an announcement in relation to an event or circumstance that has occurred may have such political support that the government has little option to withdraw. Where the government has committed to introduce and secure passage of the necessary budgetary provision such an announcement may give rise to a non-legally binding obligation;
- The ability of the entity to modify or change the obligation before it crystallizes. For example, the announcement of policy will generally not give rise to a non-legally binding obligation, which cannot be modified before being implemented. ~~Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before those events occur;~~ and
- There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, a non-legally binding obligation may exist. However, the absence of a budgetary provision does not itself mean that a present obligation has not arisen.

5.17D "Economic coercion," "political necessity" or other circumstances may give rise to situations where, although the public sector entity is not legally obliged to incur a transfer ~~an outflow~~ of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid a transfer of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.

[Paragraphs 5.18-5.26 were moved within this Chapter – see double-underlined paragraph above]

Appendix B: Chapter 6 of PBE Conceptual Framework (aligned with IPSASB) – *Recognition in Financial Statements*

Below is the existing text of the chapter on recognition (Chapter 6) in the PBE Conceptual Framework, which is aligned with the IPSASB's Chapter 6.

Recognition Criteria and their Relationship to Disclosure

6.1 This Chapter identifies the criteria that must be satisfied in order for an element to be recognised in the financial statements. Recognition is the process of incorporating and including in amounts displayed on the face of the appropriate financial statement an item that meets the definition of an element and can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information included in GPFRs.

6.2 The recognition criteria are that:

- An item satisfies the definition of an element; and
- Can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs.

6.3 All items that satisfy the recognition criteria are recognised in the financial statements. In some circumstances, a PBE Standard may also specify that, to achieve the objectives of financial reporting, a resource or obligation that does not meet the definition of an element is to be recognised in the financial statements provided it can be measured in a way that meets the qualitative characteristics and constraints. Other resources and other obligations are discussed in Chapter 5 Elements in General Purpose Financial Reports.

6.4 Recognition involves an assessment of uncertainty related to the existence and measurement of the element. The conditions that give rise to uncertainty, if any, can change. Therefore, it is important that uncertainty is assessed at each reporting date.

Definition of an Element

6.5 In order to be recognised as an element in the financial statements an item must meet the definition of one of the elements in Chapter 5. Uncertainty about the existence of an element is addressed by considering the available evidence in order to make a neutral judgement about whether an item satisfies all essential characteristics of the definition of that element, taking into account all available facts and circumstances at the reporting date.

6.6 If it is determined that an element exists, uncertainty about the amount of service potential or ability to generate economic benefits represented by that element is taken into account in the measurement of that element (see paragraphs 6.7 and 6.8). Preparers review and assess all available evidence in determining whether an element exists and is recognised, whether that element continues to qualify for recognition (see paragraph 6.9), or whether there has been a change to an existing element.

Measurement Uncertainty

6.7 In order to recognise an item in the financial statements, it is necessary to attach a monetary value to the item. This entails choosing an appropriate measurement basis and determining whether the measurement of the item achieves the qualitative characteristics, taking into account the constraints on information in GPFRs, including that the measurement is sufficiently relevant and faithfully representative for the item to be recognised in the financial statements. The selection of an appropriate measurement basis is considered in Chapter 7 *Measurement of Assets and Liabilities in Financial Statements*.

6.8 There may be uncertainty associated with the measurement of many amounts presented in the financial statements. The use of estimates is an essential part of the accrual basis of accounting. A decision about the relevance and faithful representativeness of measurement involves the consideration of techniques, such as using ranges of outcomes and point estimates, and whether additional evidence is available about economic circumstances that existed at the reporting date. Disclosures can provide useful information on estimation techniques employed. There may be rare instances in which the level of uncertainty in a single point estimate is so large that the relevance and faithful representativeness of the measure is questionable even if disclosures are provided to explain estimation techniques. Under these circumstances the item is not recognised

Disclosure and Recognition

6.9 The failure to recognise items that meet the definition of an element and the recognition criteria is not rectified by the disclosure of accounting policies, notes or other explanatory detail. However, disclosure can provide information about items that meet many, but not all the characteristics of the definition of an element. Disclosure can also provide information on items that meet the definition of an element but cannot be measured in a manner that achieves the qualitative characteristics sufficiently to meet the objectives of financial reporting. Disclosure is appropriate when knowledge of the item is considered to be relevant to the evaluation of the net financial position of the entity and therefore meets the objectives of financial reporting.

Derecognition

6.10 Derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrant removing an element that has been previously recognised from the financial statements, and removing the item if such changes have occurred. In evaluating uncertainty about the existence of an element the same criteria are used for derecognition as at initial recognition.

Appendix C: 'Recognition criteria' section from Chapter 5 in the IASB Conceptual Framework

Below is the 'recognition criteria' guidance from Chapter 5 *Recognition and Derecognition* of the IASB Conceptual Framework. We have highlighted in blue those parts that we considered particularly relevant to helping entities determine whether an obligation where the probability of the transfer of resources is low should be recognised in the financial statements.

Recognition criteria

5.6 Only items that meet the definition of an asset, a liability or equity are recognised in the statement of financial position. Similarly, only items that meet the definition of income or expenses are recognised in the statement(s) of financial performance. However, not all items that meet the definition of one of those elements are recognised.

5.7 Not recognising an item that meets the definition of one of the elements makes the statement of financial position and the statement(s) of financial performance less complete and can exclude useful information from financial statements. On the other hand, in some circumstances, recognising some items that meet the definition of one of the elements would not provide useful information. An asset or liability is recognised only if recognition of that asset or liability and of any resulting income, expenses or changes in equity provides users of financial statements with information that is useful, ie with:

(a) relevant information about the asset or liability and about any resulting income, expenses or changes in equity (see paragraphs 5.12–5.17); and

(b) a faithful representation of the asset or liability and of any resulting income, expenses or changes in equity (see paragraphs 5.18–5.25).

5.8 Just as cost constrains other financial reporting decisions, it also constrains recognition decisions. There is a cost to recognising an asset or liability. Preparers of financial statements incur costs in obtaining a relevant measure of an asset or liability. Users of financial statements also incur costs in analysing and interpreting the information provided. An asset or liability is recognised if the benefits of the information provided to users of financial statements by recognition are likely to justify the costs of providing and using that information. In some cases, the costs of recognition may outweigh its benefits.

5.9 It is not possible to define precisely when recognition of an asset or liability will provide useful information to users of financial statements, at a cost that does not outweigh its benefits. What is useful to users depends on the item and the facts and circumstances. Consequently, judgement is required when deciding whether to recognise an item, and thus recognition requirements may need to vary between and within Standards.

5.10 It is important when making decisions about recognition to consider the information that would be given if an asset or liability were not recognised. For example, if no asset is recognised when expenditure is incurred, an expense is recognised. Over time, recognising the expense may, in some cases, provide useful information, for example, information that enables users of financial statements to identify trends.

5.11 Even if an item meeting the definition of an asset or liability is not recognised, an entity may need to provide information about that item in the notes. It is important to consider how to make such information sufficiently visible to compensate for the item's absence from the structured summary provided by the statement of financial position and, if applicable, the statement(s) of financial performance.

Relevance

5.12 Information about assets, liabilities, equity, income and expenses is relevant to users of financial statements. However, recognition of a particular asset or liability and any resulting income, expenses or changes in equity may not always provide relevant information. That may be the case if, for example:

(a) it is uncertain whether an asset or liability exists (see paragraph 5.14); or

(b) an asset or liability exists, but the probability of an inflow or outflow of economic benefits is low (see paragraphs 5.15–5.17).

5.13 The presence of one or both of the factors described in paragraph 5.12 does not lead automatically to a conclusion that the information provided by recognition lacks relevance. Moreover, factors other than those described in paragraph 5.12 may also affect the conclusion. It may be a combination of factors and not any single factor that determines whether recognition provides relevant information.

Existence uncertainty

5.14 Paragraphs 4.13 and 4.35 discuss cases in which it is uncertain whether an asset or liability exists. In some cases, that uncertainty, possibly combined with a low probability of inflows or outflows of economic benefits and an exceptionally wide range of possible outcomes, may mean that the recognition of an asset or liability, necessarily measured at a single amount, would not provide relevant information. Whether or not the asset or liability is recognised, explanatory information about the uncertainties associated with it may need to be provided in the financial statements.

Low probability of an inflow or outflow of economic benefits

5.15 An asset or liability can exist even if the probability of an inflow or outflow of economic benefits is low (see paragraphs 4.15 and 4.38).

5.16 If the probability of an inflow or outflow of economic benefits is low, the most relevant information about the asset or liability may be information about the magnitude of the possible inflows or outflows, their possible timing and the factors affecting the probability of their occurrence. The typical location for such information is in the notes.

5.17 Even if the probability of an inflow or outflow of economic benefits is low, recognition of the asset or liability may provide relevant information beyond the information described in paragraph 5.16. Whether that is the case may depend on a variety of factors. For example:

(a) if an asset is acquired or a liability is incurred in an exchange transaction on market terms, its cost generally reflects the probability of an inflow or outflow of economic benefits. Thus, that cost may be relevant information, and is generally readily available. Furthermore, not recognising the asset or liability would result in the recognition of expenses or income at the time of the exchange, which might not be a faithful representation of the transaction (see paragraph 5.25(a)).

(b) if an asset or liability arises from an event that is not an exchange transaction, recognition of the asset or liability typically results in recognition of income or expenses. If there is only a low probability that the asset or liability will result in an inflow or outflow of economic benefits, users of financial statements might not regard the recognition of the asset and income, or the liability and expenses, as providing relevant information.

Faithful representation

5.18 Recognition of a particular asset or liability is appropriate if it provides not only relevant information, but also a faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. Whether a faithful representation can be provided may be affected by the level of measurement uncertainty associated with the asset or liability or by other factors.

Measurement uncertainty

5.19 For an asset or liability to be recognised, it must be measured. In many cases, such measures must be estimated and are therefore subject to measurement uncertainty. As noted in paragraph 2.19, the use of reasonable estimates is an essential part of the preparation of financial information and does not undermine the usefulness of the information if the estimates are clearly and accurately described and explained. Even a high level of measurement uncertainty does not necessarily prevent such an estimate from providing useful information.

5.20 In some cases, the level of uncertainty involved in estimating a measure of an asset or liability may be so high that it may be questionable whether the estimate would provide a sufficiently faithful representation of that asset or liability and of any resulting income, expenses or changes in equity. The level of measurement uncertainty may be so high if, for example, the only way of estimating that measure of the asset or liability is by using cash-flow-based measurement techniques and, in addition, one or more of the following circumstances exists:

(a) the range of possible outcomes is exceptionally wide and the probability of each outcome is exceptionally difficult to estimate.

(b) the measure is exceptionally sensitive to small changes in estimates of the probability of different outcomes—for example, if the probability of future cash inflows or outflows occurring is exceptionally low, but the magnitude of those cash inflows or outflows will be exceptionally high if they occur.

(c) measuring the asset or liability requires exceptionally difficult or exceptionally subjective allocations of cash flows that do not relate solely to the asset or liability being measured.

5.21 In some of the cases described in paragraph 5.20, the most useful information may be the measure that relies on the highly uncertain estimate, accompanied by a description of the estimate and an explanation of the uncertainties that affect it. This is especially likely to be the case if that measure is the most relevant measure of the asset or liability. In other cases, if that information would not provide a sufficiently faithful representation of the asset or liability and of any resulting income, expenses or changes in equity, the most useful information may be a different measure (accompanied by any necessary descriptions and explanations) that is slightly less relevant but is subject to lower measurement uncertainty.

5.22 In limited circumstances, all relevant measures of an asset or liability that are available (or can be obtained) may be subject to such high measurement uncertainty that none would provide useful information about the asset or liability (and any resulting income, expenses or changes in equity), even if the measure were accompanied by a description of the estimates made in producing it and an explanation of the uncertainties that affect those estimates. In those limited circumstances, the asset or liability would not be recognised.

5.23 Whether or not an asset or liability is recognised, a faithful representation of the asset or liability may need to include explanatory information about the uncertainties associated with the asset or liability's existence or measurement, or with its outcome—the amount or timing of any inflow or outflow of economic benefits that will ultimately result from it (see paragraphs 6.60–6.62).

Other factors

5.24 Faithful representation of a recognised asset, liability, equity, income or expenses involves not only recognition of that item, but also its measurement as well as presentation and disclosure of information about it (see Chapters 6–7).

5.25 Hence, when assessing whether the recognition of an asset or liability can provide a faithful representation of the asset or liability, it is necessary to consider not merely its description and measurement in the statement of financial position, but also:

(a) the depiction of resulting income, expenses and changes in equity. For example, if an entity acquires an asset in exchange for consideration, not recognising the asset would result in recognising expenses and would reduce the entity's profit and equity. In some cases, for example, if the entity does not consume the asset immediately, that result could provide a misleading representation that the entity's financial position has deteriorated.

(b) whether related assets and liabilities are recognised. If they are not recognised, recognition may create a recognition inconsistency (accounting mismatch). That may not provide an understandable or faithful representation of the overall effect of the transaction or other event giving rise to the asset or liability, even if explanatory information is provided in the notes.

(c) presentation and disclosure of information about the asset or liability, and resulting income, expenses or changes in equity. A complete depiction includes all information necessary for a user of financial statements to understand the economic phenomenon depicted, including all necessary descriptions and explanations. Hence, presentation and disclosure of related information can enable a recognised amount to form part of a faithful representation of an asset, a liability, equity, income or expenses.

Final Pronouncement
October 2023

IPSAS®

Conceptual Framework Update

Chapter 3, *Qualitative Characteristics*

IPSASB International Public Sector Accounting Standards Board®

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets IPSAS™ and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

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CHAPTER 3: QUALITATIVE CHARACTERISTICS

CONTENTS

Paragraphs 3.14A and 3.14B are added. Paragraph 3.32 is amended, and part of the paragraph relocated to new paragraph 3.33A. New text is underlined, deleted text is struck through and relocated text double underlined.

Introduction

3.1 GPFRs present financial and non-financial information about economic and other phenomena. The qualitative characteristics of information included in GPFRs are the attributes that make that information useful to users and support the achievement of the objectives of financial reporting. The objectives of financial reporting are to provide information useful for accountability and decision-making purposes.

3.2 The qualitative characteristics of information included in GPFRs of public sector entities are relevance, faithful representation, understandability, timeliness, comparability, and verifiability.

3.3 Pervasive constraints on information included in GPFRs are materiality, cost-benefit, and achieving an appropriate balance between the qualitative characteristics.

3.4 Each of the qualitative characteristics is integral to, and works with, the other characteristics to provide in GPFRs information useful for achieving the objectives of financial reporting. However, in practice, all qualitative characteristics may not be fully achieved, and a balance or trade-off between certain of them may be necessary.

3.5 The qualitative characteristics apply to all financial and non-financial information reported in GPFRs, including historic and prospective information, and explanatory information. However, the extent to which the qualitative characteristics can be achieved may differ depending on the degree of uncertainty and subjective assessment or opinion involved in compiling the financial and non-financial information. The need for additional guidance on interpreting and applying the qualitative characteristics to information that extends the scope of financial reporting beyond financial statements will be considered in the development of any IPSASs and RPGs that deal with such matters.

Relevance

3.6 Financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of financial reporting. Financial and non-financial information is capable of making a difference when it has confirmatory value, predictive value, or both. It may be capable of making a difference, and thus be relevant, even if some users choose not to take advantage of it or are already aware of it.

3.7 Financial and non-financial information has confirmatory value if it confirms or changes past (or present) expectations. For example, information will be relevant for accountability and decision-making purposes if it confirms expectations about such matters as the extent to which managers have discharged their responsibilities for the efficient and effective use of resources, the achievement of specified service delivery objectives, and compliance with relevant budgetary, legislative and other requirements.

3.8 GPFRs may present information about an entity's anticipated future service delivery activities, objectives and costs, and the amount and sources of the resources that are intended to be allocated to providing services in the future. Such future oriented information will have predictive value and be relevant for accountability and decision-making purposes. Information about economic and other phenomena that exist or have already occurred can also have predictive value in helping form expectations about the future. For example, information that confirms or disproves past expectations can reinforce or change expectations about financial results and service delivery outcomes that may occur in the future.

3.9 The confirmatory and predictive roles of information are interrelated—for example, information about the current level and structure of an entity's resources and claims to those resources helps users to confirm the outcome of resource management strategies during the period, and to predict an entity's ability to respond to changing circumstances and anticipated future service delivery needs. The same information helps to confirm or correct users' past expectations and predictions about the entity's ability to respond to such changes. It also helps to confirm or correct prospective financial information included in previous GPFRs.

Faithful Representation

3.10 To be useful in financial reporting, information must be a faithful representation of the economic and other phenomena that it purports to represent. Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error. Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance—which is not necessarily always the same as its legal form.

3.11 In practice, it may not be possible to know or confirm whether information presented in GPFRs is complete, neutral, and free from material error. However, information should be as complete, neutral, and free from error as is possible.

3.12 An omission of some information can cause the representation of an economic or other phenomenon to be false or misleading, and thus not useful to users of GPFRs. For example, a complete depiction of the item "plant and equipment" in GPFRs will include a numeric representation of the aggregate amount of plant and equipment together with other quantitative, descriptive and explanatory information necessary to faithfully represent that class of assets. In some cases, this may include the disclosure of information about such matters as the major classes of plant and equipment, factors that have affected their use in the past or might impact on their use in the future, and the basis and process for determining their numeric representation. Similarly, prospective financial and non-financial information and information about the achievement of service delivery objectives and outcomes included in GPFRs will need to be presented with the key assumptions that underlie that information and any explanations that are necessary to ensure that its depiction is complete and useful to users.

3.13 Neutrality in financial reporting is the absence of bias. It means that the selection and presentation of financial and non-financial information is not made with the intention of attaining a particular predetermined result—for example, to influence in a particular way users' assessment of the discharge of accountability by the entity or a decision or judgment that is to be made, or to induce particular behavior.

3.14 Neutral information faithfully represents the economic and other phenomena that it purports to represent. However, to require information included in GPFRs to be neutral does not mean that it is not without purpose or that it will not influence behavior. Relevance is a qualitative characteristic and, by definition, relevant information is capable of influencing users' assessments and decisions.

3.14A Neutrality is supported by the exercise of prudence. Prudence is the exercise of caution when making judgments under conditions of uncertainty. The exercise of prudence means that assets and revenue are not overstated, and liabilities and expense are not understated. Equally, the exercise of prudence does not allow for the understatement of assets or revenue or the overstatement of liabilities or expense. Such misstatements can lead to the overstatement or understatement of revenue or expense in future reporting periods.

3.14B The exercise of prudence does not imply a need for asymmetry; for example, a systematic need for more persuasive evidence to support the recognition of assets or revenue than the recognition of liabilities or expense. Particular standards may contain asymmetric requirements where this is a consequence of decisions intended to select the most relevant information that faithfully represents what it purports to represent.

3.15 The economic and other phenomena represented in GPFRs generally occur under conditions of uncertainty. Information included in GPFRs will therefore often include estimates that incorporate management's judgment. To faithfully represent an economic or other phenomenon, an estimate must be based on appropriate inputs, and each input must reflect the best available information. Caution will need to be exercised when dealing with uncertainty. It may sometimes be necessary to explicitly disclose the degree of uncertainty in financial and non-financial information to faithfully represent economic and other phenomena.

3.16 Free from material error does not mean complete accuracy in all respects. Free from material error means there are no errors or omissions that are individually or collectively material in the description of the phenomenon, and the process used to produce the reported information has been applied as described. In some cases, it may be possible to determine the accuracy of some information included in GPFRs—for example, the amount of a cash transfer to another level of government, the volume of services delivered, or the price paid for the acquisition of plant and equipment. However, in other cases it may not—for example, the accuracy of an estimate of the value or cost of an item or the effectiveness of a service delivery program may not be able to be determined. In these cases, the estimate will be free from material error if the amount is clearly described as an estimate, the nature and limitations of the estimation process are explained, and no material errors have been identified in selecting and applying an appropriate process for developing the estimate.

Understandability

3.17 Understandability is the quality of information that enables users to comprehend its meaning. GPFRs of public sector entities should present information in a manner that responds to the needs and knowledge base of users, and to the nature of the information presented. For example, explanations of financial and non-financial information and commentary on service delivery and other achievements during the reporting period and expectations for future periods should be written in plain language and presented in a manner that is readily understandable by users. Understandability is enhanced when information is classified, characterized, and presented clearly and concisely. Comparability also can enhance understandability.

3.18 Users of GPFRs are assumed to have a reasonable knowledge of the entity's activities and the environment in which it operates, to be able and prepared to read GPFRs, and to review and analyze the information presented with reasonable diligence. Some economic and other phenomena are particularly complex and difficult to represent in GPFRs, and some users may need to seek the aid of an advisor to assist in their understanding of them. All efforts should be undertaken to represent economic and other phenomena included in GPFRs in a manner that is understandable to a wide range of users. However, information should not be excluded from

GPFRs solely because it may be too complex or difficult for some users to understand without assistance.

Timeliness

3.19 Timeliness means having information available for users before it loses its capacity to be useful for accountability and decision-making purposes. Having relevant information available sooner can enhance its usefulness as input to assessments of accountability and its capacity to inform and influence decisions that need to be made. A lack of timeliness can render information less useful.

3.20 Some items of information may continue to be useful long after the reporting period or reporting date. For example, for accountability and decision-making purposes, users of GPFRs may need to assess trends in the financial and service delivery performance of the entity and its compliance with budgets over a number of reporting periods. In addition, the outcome and effects of some service delivery programs may not be determinable until future periods—for example, this may occur in respect of programs intended to enhance the economic well-being of constituents, reduce the incidence of a particular disease, or increase literacy levels of certain age groups.

Comparability

3.21 Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena. Comparability is not a quality of an individual item of information, but rather a quality of the relationship between two or more items of information.

3.22 Comparability differs from consistency. Consistency refers to the use of the same accounting principles or policies and basis of preparation, either from period to period within an entity or in a single period across more than one entity. Comparability is the goal, and consistency helps in achieving that goal. In some cases, the accounting principles or policies adopted by an entity may be revised to better represent a particular transaction or event in GPFRs. In these cases, the inclusion of additional disclosures or explanation may be necessary to satisfy the characteristics of comparability.

3.23 Comparability also differs from uniformity. For information to be comparable, like things must look alike and different things must look different. An over-emphasis on uniformity may reduce comparability by making unlike things look alike. Comparability of information in GPFRs is not enhanced by making unlike things look alike, any more than it is by making like things look different.

3.24 Information about the entity's financial position, financial performance, cash flows, compliance with approved budgets and relevant legislation or other authority governing the raising and use of resources, service delivery achievements, and its future plans is necessary for accountability purposes and useful as input for decision-making purposes. The usefulness of such information is enhanced if it can be compared with, for example:

- Prospective financial and non-financial information previously presented for that reporting period or reporting date;
- Similar information about the same entity for some other period or some other point in time; and
- Similar information about other entities (for example, public sector entities providing similar services in different jurisdictions) for the same reporting period.

3.25 Consistent application of accounting principles, policies and basis of preparation to prospective financial and non-financial information and actual outcomes will enhance the usefulness of any comparison of projected and actual results. Comparability with other entities may be less significant for explanations of management's perception or opinion of the factors underlying the entity's current performance.

Verifiability

3.26 Verifiability is the quality of information that helps assure users that information in GPFRs faithfully represents the economic and other phenomena that it purports to represent. Supportability is sometimes used to describe this quality when applied in respect of explanatory information and prospective financial and non-financial quantitative information disclosed in GPFRs—that is, the quality of information that helps assure users that explanatory or prospective financial and non-financial quantitative information faithfully represents the economic and other phenomena that it purports to represent. Whether referred to as verifiability or supportability, the characteristic implies that different knowledgeable and independent observers could reach general consensus, although not necessarily complete agreement, that either:

- The information represents the economic and other phenomena that it purports to represent without material error or bias; or
- An appropriate recognition, measurement, or representation method has been applied without material error or bias.

3.27 To be verifiable, information need not be a single point estimate. A range of possible amounts and the related probabilities also can be verified.

3.28 Verification may be direct or indirect. With direct verification, an amount or other representation is itself verified, such as by (a) counting cash, (b) observing marketable securities and their quoted prices, or (c) confirming that the factors identified as influencing past service delivery performance were present and operated with the effect identified. With indirect verification, the amount or other representation is verified by checking the inputs and recalculating the outputs using the same accounting convention or methodology. An example is verifying the carrying amount of inventory by checking the inputs (quantities and costs) and recalculating the ending inventory using the same cost flow assumption (for example, average cost or first-in-first-out).

3.29 The quality of verifiability (or supportability if such term is used to describe this characteristic) is not an absolute—some information may be more or less capable of verification than other information. However, the more verifiable is the information included in GPFRs, the more it will assure users that the information faithfully represents the economic and other phenomena that it purports to represent.

3.30 GPFRs of public sector entities may include financial and other quantitative information and explanations about (a) key influences on the entity's performance during the period, (b) the anticipated future effects or outcomes of service delivery programs undertaken during the reporting period, and (c) prospective financial and non-financial information. It may not be possible to verify the accuracy of all quantitative representations and explanations of such information until a future period, if at all.

3.31 To help assure users that prospective financial and non-financial quantitative information and explanations included in GPFRs faithfully represent the economic and other phenomena that they purport to represent, the assumptions that underlie the information disclosed, the methodologies adopted in compiling that information, and the factors and circumstances that support any opinions expressed or disclosures made should be transparent. This will enable users to form judgments about the appropriateness of those assumptions and the method of compilation, measurement, representation and interpretation of the information.

Constraints on Information Included in General Purpose Financial Reports

Materiality

3.32 Information is material if ~~its omission or misstatement~~ omitting, misstating or obscuring it could reasonably be expected ~~could~~ to influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs prepared for that reporting period. Materiality depends on both the nature and amount of the item judged in the particular circumstances of each entity.

3.33 Assessments of materiality will be made in the context of the legislative, institutional and operating environment within which the entity operates and, in respect of prospective financial and non-financial information, the preparer's knowledge and expectations about the future. Disclosure of information about compliance or non-compliance with legislation, regulation or other authority may be material because of its nature—irrespective of the magnitude of any amounts involved. In determining whether an item is material in these circumstances, consideration will be given to such matters as the nature, legality, sensitivity and consequences of past or anticipated transactions and events, the parties involved in any such transactions and the circumstances giving rise to them.

3.33A GPFRs may encompass qualitative and quantitative information about service delivery achievements during the reporting period, and expectations about service delivery and financial outcomes in the future. Consequently, it is not possible to specify a uniform ~~quantitative threshold~~ characteristic or a uniform set of characteristics at which a particular type of information becomes material.

3.34 Materiality is classified as a constraint on information included in GPFRs in the Conceptual Framework. In developing IPSASs and RPGs, the IPSASB will consider the materiality of the consequences of application of a particular accounting policy, basis of preparation or disclosure of a particular item or type of information. Subject to the requirements of any IPSAS, entities preparing GPFRs will also consider the materiality of, for example, the application of a particular accounting policy and the separate disclosure of particular items of information.

Cost-Benefit

3.35 Financial reporting imposes costs. The benefits of financial reporting should justify those costs. Assessing whether the benefits of providing information justify the related costs is often a matter of judgment, because it is often not possible to identify and/or quantify all the costs and all the benefits of information included in GPFRs.

3.36 The costs of providing information include the costs of collecting and processing the information, the costs of verifying it and/or presenting the assumptions and methodologies that support it, and the costs of disseminating it. Users incur the costs of analysis and interpretation. Omission of useful information also imposes costs, including the costs that users incur to obtain needed information from other sources and the costs that result from making decisions using incomplete data provided by GPFRs.

3.37 Preparers expend the majority of the effort to provide information in GPFRs. However, service recipients and resource providers ultimately bear the cost of those efforts—because resources are redirected from service delivery activities to preparation of information for inclusion in GPFRs.

3.38 Users reap the majority of benefits from the information provided by GPFRs. However, information prepared for GPFRs may also be used internally by management and result in better decision making by management. The disclosure of information in GPFRs consistent with the concepts identified in the Conceptual Framework and IPSASs and RPGs derived from them will enhance and reinforce perceptions of the transparency of financial reporting by governments and other public sector entities and contribute to the more accurate pricing of public sector debt. Therefore, public sector entities may also benefit in a number of ways from the information provided by GPFRs.

3.39 Application of the cost-benefit constraint involves assessing whether the benefits of reporting information are likely to justify the costs incurred to provide and use the information. When making this assessment, it is necessary to consider whether one or more qualitative characteristics might be sacrificed to some degree to reduce cost.

3.40 In developing IPSASs, the IPSASB considers information from preparers, users, academics, and others about the expected nature and quantity of the benefits and costs of the proposed requirements. Disclosure and other requirements which result in the presentation of information useful to users of GPFRs for accountability and decision-making purposes and satisfy the qualitative characteristics are prescribed by IPSASs when the benefits of compliance with those disclosures and other requirements are assessed by the IPSASB to justify their costs.

Balance Between the Qualitative Characteristics

3.41 The qualitative characteristics work together to contribute to the usefulness of information. For example, neither a depiction that faithfully represents an irrelevant phenomenon, nor a depiction that unfaithfully represents a relevant phenomenon, results in useful information. Similarly, to be relevant, information must be timely and understandable.

3.42 In some cases, a balancing or trade-off between qualitative characteristics may be necessary to achieve the objectives of financial reporting. The relative importance of the qualitative characteristics in each situation is a matter of professional judgment. The aim is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial reporting.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

Qualitative Characteristics of Information Included in General Purpose Financial Reports

BC3.1 In developing IPSASs, the IPSASB receives input from constituents on, and makes judgments about, information that best satisfies the objectives of financial reporting and should be included in GPFRs. In making those judgments, the IPSASB considers the extent to which each of the qualitative characteristics can be achieved. Disclosure and other requirements are included in IPSASs only when the information that results from their application is considered to satisfy the qualitative characteristics and the cost-benefit constraint identified in the Conceptual Framework.

BC3.2 Some respondents to the Exposure Draft issued in 2010 (the 2010 Exposure Draft) expressed concern about the application of the qualitative characteristics to all matters that may be presented in GPFRs, particularly those matters that may be presented in reports outside the financial statements. The IPSASB understands this concern. The IPSASB acknowledges that IPSASs and RPGs that deal with the presentation in GPFRs of information outside the financial statements may need to include additional guidance on the application of the qualitative characteristics to the matters dealt with.

BC3.3 IPSASs and RPGs issued by the IPSASB will not deal with all financial and non-financial information that may be included in GPFRs. In the absence of an IPSAS or RPG that deals with particular economic or other phenomena, assessments of whether an item of information satisfies the qualitative characteristics and constraints identified in the Conceptual Framework, and therefore qualifies for inclusion in GPFRs, will be made by preparers compiling the GPFRs. Those assessments will be made in the context of achieving the objectives of financial reporting, which in turn have been developed to respond to users' information needs.

BC3.4 Having in place accounting systems and processes that are appropriately designed and are operated effectively will enable management to gather and process evidence to support financial reporting. The quality of these systems and processes is a key factor in ensuring the quality of financial information that the entity includes in GPFRs.

Limited Scope Update of Conceptual Framework

BC3.4A In March 2020 the IPSASB initiated a Limited Scope Update of the Conceptual Framework. The Limited Scope Update proposed modifications to the guidance on materiality and the addition of guidance on the role of prudence in the context of faithful representation. The IPSASB approved an updated Chapter 3 in June 2023. The IPSASB started using updated Chapter 3 immediately once approved.

Other Qualitative Characteristics Considered

BC3.5 Some respondents to the 2010 Exposure Draft expressed the view that additional qualitative characteristics should be identified. Those qualitative characteristics included "sincerity," "true and fair view," "credibility," "transparency," and "regularity".

BC3.6 The IPSASB noted that "sincerity" as used in financial reporting has a similar meaning to "true and fair". The IPSASB ~~is of~~ took the view that sincerity, true and fair view, credibility, and transparency are important expressions of the overarching qualities that financial reporting is to achieve or aspire to. However, they do not exist as single qualitative characteristics on their own—rather, achieving these qualities is the product of application of the full set of qualitative characteristics identified in the Conceptual Framework, and the IPSASs that deal with specific reporting issues. Consequently, while important characteristics of GPFRs, they are not identified as separate individual qualitative characteristics in their own right. The IPSASB ~~is also of~~ also took the view that the notion of "regularity" as noted by some respondents is related to the notion of "compliance" as used in the Conceptual Framework—therefore, regularity is not identified as an additional qualitative characteristic.

Relevance

BC3.7 The Conceptual Framework explains that financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of financial reporting. As part of its due process the IPSASB seeks input on whether the requirements of a proposed IPSAS or any proposed RPGs are relevant to the achievement of the objectives of financial reporting—that is, are relevant to the discharge of the entity's obligation to be accountable and to decisions that users may make.

Faithful Representation

BC3.8 The Conceptual Framework explains that to be useful information must be a faithful representation of the economic and other phenomena that it purports to represent. A single economic or other phenomenon may be faithfully represented in many ways. For example, the achievement of particular service delivery objectives may be depicted (a) qualitatively through an explanation of the immediate and anticipated longer term outcomes and effects of the service delivery program, (b) quantitatively as a measure of the volume and cost of services provided by the service delivery program, or (c) by a combination of both qualitative and quantitative information. Additionally, a single depiction in GPFRs may represent several economic or other phenomena. For example, the presentation of the item "plant and equipment" in a financial statement may represent an aggregate of all of an entity's plant and equipment, including items that have different functions, that are subject to different risks and opportunities and that are carried at amounts based on estimates that may be more or less complex and reliable.

BC3.9 Completeness and neutrality of estimates (and inputs to those estimates) and freedom from material error are desirable, and some minimum level of accuracy is necessary for an estimate to faithfully represent an economic or other phenomenon. However, faithful representation does not imply absolute completeness or neutrality in the estimate, nor does it imply total freedom from error in the outcome. For a representation of an economic or other phenomenon to imply a degree of completeness, neutrality, or freedom from error that is impracticable for it to achieve would diminish the extent to which the information faithfully represents the economic or other phenomenon that it purports to represent.

Faithful Representation or Reliability

BC3.10 At the time of issue of the 2010 Exposure Draft, Appendix A of IPSAS 1, *Presentation of Financial Statements,* identified "reliability" as a qualitative characteristic. It described reliable information as information that is "free from material error and bias, and can be depended on by users to represent faithfully that which it purports to represent or could reasonably be expected to represent." Faithful representation, substance over form, neutrality, prudence and completeness were identified as components of reliability. The Conceptual Framework uses the term "faithful representation" rather than "reliability" to describe what is substantially the same concept. In addition, it does not explicitly identify substance over form and prudence as components of faithful representation.

BC3.11 Many respondents to the 2010 Exposure Draft supported the use of faithful representation and its explanation in the 2010 Exposure Draft, in some cases explaining that faithful representation is a better expression of the nature of the concept intended. Some respondents did not support the replacement of reliability with the term faithful representation, expressing concerns including that faithful representation implies the adoption of fair value or market value accounting, and reliability and faithful representation are not interchangeable terms.

BC3.12 The use of the term "faithful representation", or "reliability" for that matter, to describe this qualitative characteristic in the Conceptual Framework will not determine the measurement basis to be adopted in GPFRs, whether historical cost, ~~market value~~, fair value, cost of fulfillment, or another measurement basis. The IPSASB ~~does~~ did not intend that use of faithful representation be interpreted as such. The measurement basis or measurement bases that may be adopted for the elements of financial statements are considered in Chapter 7, *Measurement of Assets and Liabilities in Financial Statements*. The qualitative characteristics will then operate to ensure that the financial statements faithfully represent the measurement basis or bases reflected in GPFRs.

BC3.13 The IPSASB ~~appreciates~~ appreciated the concern of some respondents that the use of a different term may be interpreted to reflect different, and even lesser, qualities to those communicated by the term reliability. However, the IPSASB took ~~is of~~ the view that explanation in the Conceptual Framework that "Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error", and the elaboration of these key features will protect against the loss of any of the qualities that were formerly reflected in the use of the term reliability.

BC3.14 In addition, the IPSASB ~~has been~~ was advised that the term "reliability" is itself open to different interpretations and subjective judgments, with consequences for the quality of information included in GPFRs. The IPSASB took ~~is of~~ the view that use of the term "faithful representation" would overcome problems in the interpretation and application of reliability that have been experienced in some jurisdictions without a lessening of the qualities intended by the term, and is more readily translated into, and understood in, a wide range of languages.

Substance over Form and Prudence

BC3.15 Some respondents to the 2010 Exposure Draft expressed concern that substance over form and prudence ~~are~~ were not identified as qualitative characteristics or that their importance is not sufficiently recognized or explained. Some also noted that prudence need not be incompatible with the achievement of neutrality and faithful representation.

BC3.16 The Conceptual Framework explains that "Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance—which is not necessarily always the same as its legal form." Therefore, substance over form remains a key quality that information included in GPFRs must possess. It is not identified as a separate or additional qualitative characteristic because it is already embedded in the notion of faithful representation.

BC3.17 The IPSASB ~~is of~~ took the view that the notion of prudence was also reflected in the explanation of neutrality as a component of faithful representation, and the acknowledgement of the need to exercise caution in dealing with uncertainty. Therefore, like substance over form, prudence ~~is~~ was not identified as a separate qualitative characteristic because its intent and influence in identifying information that is included in GPFRs was already embedded in the notion of faithful representation.

BC3.17A The International Accounting Standards Board (IASB) revised its approach to prudence in the *Conceptual Framework for Financial Reporting*, published in 2018 (the IASB 2018 Conceptual Framework). The IASB did not include prudence as a qualitative characteristic, but, in the context of faithful representation, explained that "neutrality is supported by the exercise of prudence" and that "prudence is the exercise of caution when making judgments under conditions of uncertainty". The IASB characterized the approach adopted in the 2018 Conceptual Framework as "cautious prudence".

BC3.17B The IPSASB also noted that prudence had been the subject of much discussion in the European Public Sector Accounting Standards project.

BC3.17C Because of the above developments, the IPSASB reconsidered the approach to prudence in the 2014 Conceptual Framework: in particular whether prudence should be included as a qualitative characteristic in its own right, or whether guidance on prudence should be included in the context of neutrality and faithful representation.

BC3.17D The IPSASB considered that prudence is insufficiently distinct from faithful representation to justify inclusion as an additional qualitative characteristic. Practical application of the IPSASB Conceptual Framework has also not identified that the non-inclusion of prudence as a qualitative characteristic is problematic.

BC3.17E The IPSASB acknowledged the case for retaining the approach in the 2014 Conceptual Framework on the grounds that an allusion to, and discussion of, prudence, adds little to the notion of neutrality, which itself conveys a lack of bias. However, the IPSASB concluded that clarifying that prudence entails caution in assessing uncertainty in the measurement of all elements would be beneficial and would respond to those who view the absence of references to prudence as a risk. The IPSASB is firmly of the view that caution should be applied consistently rather than focusing disproportionately on assets and revenue. The IPSASB therefore decided to include an explanation in paragraph 3.14A that, in the context of faithful representation, "neutrality is supported by the exercise of prudence", and that "prudence is the exercise of caution when making judgments under conditions of uncertainty". This is consistent with the approach of the IASB in its 2018 Conceptual Framework.

BC3.17F While most respondents to Exposure Draft (ED) 81, issued in February 2022, supported the proposed approach, a minority advocated the adoption of prudence as a qualitative characteristic. The IPSASB acknowledged this view but concluded that the consultation had not raised compelling reasons for the inclusion of prudence as a qualitative characteristic—in particular to substantiate a case that prudence is sufficiently distinct from faithful representation to justify inclusion as an additional qualitative characteristic. The IPSASB therefore confirmed the proposals in ED 81.

BC3.17G Some respondents to ED 81 considered that the contrast between symmetry and asymmetry had been insufficiently explained. The IPSASB agreed with this observation. The IPSASB did not consider that the principle in paragraph 3.14B that the exercise of prudence does not imply a need for asymmetry should be modified. Rather, there should be a clarification of what is meant by "asymmetry" in order to clarify the IPSASB's conclusion. The IPSASB confirmed that the most common attribute of asymmetry is that a higher standard of evidence is required for the recognition of assets and revenue than for liabilities and expenses. While there is no universally accepted definition of asymmetry the IPSASB also considered that the application of asymmetry might include:

- The non-recognition of all unrealized gains; or
- Permitting preparers to measure an asset at an amount lower than an unbiased estimate and a liability at an amount higher than an unbiased estimate under the measurement bases selected for the asset and the liability.

BC 3.17H The IPSASB concluded that the introduction of such an approach would not result in information that is relevant and provides a faithful representation of an entity's financial position and financial performance. Therefore, such an approach would not meet the objectives of financial reporting identified in Chapter 2, *Objectives and Users of General Purpose Financial Reporting.*

Understandability

BC3.18 Although presenting information clearly and concisely helps users to comprehend it, the actual comprehension or understanding of information depends largely on the users of the GPFRs.

BC3.19 Some economic and other phenomena are particularly complex and difficult to represent in GPFRs. However, the IPSASB is of the view that information that is, for example, relevant, a faithful representation of what it purports to represent, timely and verifiable should not be excluded from GPFRs solely because it may be too complex or difficult for some users to understand without assistance. Acknowledging that it may be necessary for some users to seek assistance to understand the information presented in GPFRs does not mean that information included in GPFRs need not be understandable or that all efforts should not be undertaken to present information in GPFRs in a manner that is understandable to a wide range of users. However, it does reflect that, in practice, the nature of the information included in GPFRs is such that all the qualitative characteristics may not be fully achievable at all times for all users.

Timeliness

BC3.20 The IPSASB recognizes the potential for timely reporting to increase the usefulness of GPFRs for both accountability and decision-making purposes, and that undue delay in the provision of information may reduce its usefulness for these purposes. Consequently, timeliness is identified as a qualitative characteristic in the Conceptual Framework.

Comparability

BC3.21 Some degree of comparability may be attained by maximizing the qualitative characteristics of relevance and faithful representation. For example, faithful representation of a relevant economic or other phenomenon by one public sector entity is likely to be comparable to a faithful representation of a similar relevant economic or other phenomenon by another public sector entity. However, a single economic or other phenomenon can often be faithfully represented in several ways and permitting alternative accounting methods for the same phenomenon diminishes comparability and, therefore, may be undesirable.

BC3.22 Some respondents to the 2010 Exposure Draft expressed concern that the explanation of the relationship between comparability and consistency ~~may~~ might be read as presenting an obstacle to the on-going development of financial reporting. This ~~is~~ was because enhancements in financial reporting often involve a revision or change to the accounting principles, policies or basis of preparation currently adopted by the entity.

BC3.23 Consistent application of the same accounting principles, policies and basis of preparation from one period to the next will assist users in assessing the financial position, financial performance and service delivery achievements of the entity compared with previous periods. However, where accounting principles or policies dealing with particular transactions or other events are not prescribed by IPSASs, achievement of the qualitative characteristic of comparability should not be interpreted as prohibiting the entity from changing its accounting principles or policies to better represent those transactions and events. In these cases, the inclusion in GPFRs of additional disclosures or explanation of the impact of the changed policy can still satisfy the characteristics of comparability.

Verifiability

BC3.24 Verifiability is the quality of information that helps assure users that information in GPFRs faithfully represents the economic and other phenomena that it purports to represent. While closely linked to faithful representation, verifiability is identified as a separate qualitative characteristic because information may faithfully represent economic and other phenomena even though it cannot be verified with absolute certainty. In addition, verifiability may work in different ways with faithful representation and other of the qualitative characteristics to contribute to the usefulness of information presented in GPFRs—for example, there may need to be an appropriate balance between the degree of verifiability an item of information may possess and other qualitative characteristics to ensure it is presented in a timely fashion and is relevant.

BC3.25 In developing the qualitative characteristics identified in the Conceptual Framework, the IPSASB considered whether "supportability" should be identified as a separate characteristic for application to information presented in GPFRs outside the financial statements. The IPSASB is of the view that identifying both verifiability and supportability as separate qualitative characteristics with essentially the same features may be confusing to preparers and users of GPFRs and others. However, the Conceptual Framework does acknowledge that supportability is sometimes used to refer to the quality of information that helps assure users that explanatory information and prospective financial and non-financial information included in GPFRs faithfully represent the economic and other phenomena that they purport to represent.

BC3.26 Some respondents to the 2010 Exposure Draft expressed concern about the application of verifiability to the broad range of matters that may be presented in GPFRs outside the financial statements, particularly explanatory information about service delivery achievements during the reporting period and qualitative and quantitative prospective financial and non-financial information. The IPSASB ~~is~~ was of the view that the Conceptual Framework provides appropriate guidance on the application of verifiability in respect of these matters—for example it explains that verifiability is not an absolute and it may not be possible to verify the accuracy of all quantitative representations and explanations until a future period. The Conceptual Framework also acknowledges that disclosure of the underlying assumptions and methodologies adopted for the compilation of explanatory and prospective financial and non-financial information is central to the achievement of faithful representation.

Classification of the Qualitative Characteristics and Order of their Application

BC3.27 Some respondents to the 2010 Exposure Draft expressed the view that the Conceptual Framework should identify:

- Relevance and faithful representation as fundamental qualitative characteristics, and explain the order of their application; and
- Comparability, verifiability, timeliness, and understandability as enhancing qualitative characteristics.

They noted that this would provide useful guidance on the sequence of application of the qualitative characteristics and reflect the approach adopted by the IASB. ~~International Accounting Standards Board~~

BC3.28 In developing the qualitative characteristics, the IPSASB considered whether some characteristics should be identified as fundamental, and others identified as enhancing. The IPSASB also considered whether the order of application of the characteristics should be identified and/or explained. The IPSASB ~~is~~ was of the view that such an approach should not be adopted because, for example:

- Matters identified as "fundamental" ~~may~~ might be perceived to be more important than those identified as "enhancing", even if this distinction is not intended in the case of the qualitative characteristics. As a result, there may be unintended consequences of identifying some qualitative characteristics as fundamental and others as enhancing;
- All the qualitative characteristics are important and work together to contribute to the usefulness of information. The relative importance of a particular qualitative characteristic in different circumstances is a matter of professional judgment. As such, it is not appropriate to identify certain qualitative characteristics as always being fundamental and others as having only an enhancing or supporting role, or to specify the sequence of their application, no matter what information is being considered for inclusion in GPFRs, and irrespective of the circumstances of the entity and its environment. In addition, it is questionable whether information that is not understandable or is provided so long after the event as not to be useful to users for accountability and decision-making purposes could be considered as relevant information—therefore, these characteristics are themselves fundamental to the achievement of the objectives of financial reporting; and
- GPFRs of public sector entities may encompass historical and prospective information about financial performance and the achievement of service delivery objectives over a number of reporting periods. This provides necessary input to assessments of trends in service delivery activities and resources committed thereto—for such trend data, reporting on a comparable basis may be as important as, and cannot be separated from, faithful representation of the information.

Constraints on Information Included in General Purpose Financial Reports

~~Materiality~~ **Materiality**

BC3.29 At the time of issue of the 2010 Exposure Draft, Appendix A of IPSAS 1 described materiality with similar characteristics to that described in the Conceptual Framework but identified materiality as a factor to be considered in determining only the relevance of information. Some respondents to the Exposure Draft noted that materiality may be identified as an aspect of relevance.

BC3.30 The IPSASB ~~has~~ considered whether materiality should be identified as an entity-specific aspect of relevance rather than a constraint on information included in GPFRs. As explained in the Conceptual Framework, and subject to requirements in an IPSAS, materiality will be considered by preparers in determining whether, for example, a particular accounting policy should be adopted, or an item of information should be separately disclosed in the financial statements of the entity.

BC3.31 However, the IPSASB ~~is of~~ took the view that materiality has a more pervasive role than would be reflected by its classification as only an entity specific aspect of relevance. For example, materiality relates to, and can impact, a number of the qualitative characteristics of information included in GPFRs. Therefore, the materiality of an item should be considered when determining whether the omission or misstatement of an item of information could undermine not only the relevance, but also the faithful representation, understandability or verifiability of financial and non-financial information presented in GPFRs. The IPSASB ~~is~~ was also of the view that whether the effects of the application of a particular accounting policy or basis of preparation or the information content of separate disclosure of certain items of information are likely to be material should be considered in establishing IPSASs and RPGs. Consequently, the IPSASB ~~is~~ was of the view that materiality is better reflected as a broad constraint on information to be included in GPFRs.

BC3.32 The IPSASB considered whether the Conceptual Framework should reflect that legislation, regulation or other authority may impose financial reporting requirements on public sector entities in addition to those imposed by IPSASs. The IPSASB ~~is~~ was of the view that, while a feature of the operating environment of many public sector (and many private sector) entities, the impact that legislation or other authority may have on the information included in GPFRs is not itself a financial reporting concept. Consequently, ~~it~~ the IPSASB has not identified it as such in the Conceptual Framework. Preparers will, of course, need to consider such requirements as they prepare GPFRs. In particular, legislation may prescribe that particular item of information are to be disclosed in GPFRs even though they may not be judged to satisfy a materiality threshold (or cost-benefit constraint) as identified in the Conceptual Framework. Similarly, the disclosure of some matters may be prohibited by legislation because, for example, they relate to matters of national security, notwithstanding that they are material and would otherwise satisfy the cost-benefit constraint.

BC3.32A In 2018 the IASB amended IAS 1, *Presentation of Financial Statements*, and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. The amendments clarified the definition of material in order to resolve difficulties that entities experience in making materiality judgments when preparing financial statements, and to align the definitions in both standards. Because of these changes the IASB made minor, but significant, amendments to Chapter 2, *Qualitative Characteristics of Useful Financial Information*, of its 2018 Conceptual Framework. First, an amendment complemented the guidance that information is material if omitting or misstating it could influence decision making with a reference to “obscuring information” as a further factor. A second amendment softened the threshold for entities in determining when information is material.

BC3.32B In its Limited Scope Update project initiated in 2020 the IPSASB considered both changes in the context of public sector general purpose financial reporting. The IPSASB concluded that the reference to “obscuring information” is relevant to the public sector, as it suggests that, amongst other practices, the inclusion of immaterial disclosures can have a negative impact on users, rather than just being unnecessary. This is a relevant consideration for both the financial statements and other GPFRs. The IPSASB also concluded that modifying the wording on adversely influencing users by adding the words “reasonably be expected to influence” imposes a more realistic expectation on preparers’ assessments of materiality. The IPSASB therefore decided to adopt these changes in its Conceptual Framework and amended paragraph 3.32 accordingly. In ED 81, the IPSASB proposed the addition of a sentence that “where an entity judges that a material item is not separately displayed on the face of a financial statement (or displayed sufficiently prominently) an entity considers disclosure”. The intention was to provide further useful guidance to preparers.

BC3.32C The majority of respondents to ED 81 supported the addition of “obscuring information” as a factor relevant to materiality. They also supported softening the threshold for determining when information is material. Some respondents requested that the Conceptual Framework include examples of how material information is obscured. The IPSASB considers that the role of the Conceptual Framework is to provide high-level principles rather than to include detailed examples; such examples risk diverting attention from the core principle and are better provided elsewhere in the IPSASB’s literature.

BC3.32D A number of respondents expressed reservations about the additional sentence in paragraph 3.32. These reservations highlighted two points. First, some respondents felt that the sentence risked undermining the principle in paragraph 6.9 of Chapter 6, *Recognition in Financial Statements,* that “the failure to recognize items that meet the definition of an element and the recognition criteria is not rectified by the disclosure of accounting policies, notes or other explanatory detail”. Second, some respondents felt that the sentence related to presentation and was therefore inappropriate for Chapter 3.

BC3.32E The IPSASB’s intention was not to undermine the key principle that disclosure is not an alternative to recognition of an item that meets the definition of an element and the recognition criteria. However, the IPSASB accepted that the sentence risked such an interpretation. The IPSASB also accepted that issues of display and disclosure are addressed in Chapter 8, *Presentation in General Purpose Financial Reports,* and are inappropriate for Chapter 3. The IPSASB therefore decided not to include this additional sentence in the updated Chapter 3.

BC3.32F In the IASB’s 2018 Conceptual Framework, materiality is an aspect of the qualitative characteristic of relevance, rather than a constraint on information in general purpose financial reports as in the IPSASB Conceptual Framework. In the Limited Scope Update the IPSASB did not reassess this classification. The IPSASB acknowledged that materiality can impact a number of qualitative characteristics.

BC3.32G In the Limited Scope Update the IPSASB acknowledged that in a number of jurisdictions, public sector entities are required to report on whether transactions have been recorded in accordance with governing legislation and regulations. In some jurisdictions such reports are referred to as a regularity assertion or statement. Auditors may be required to express an opinion on such statements, separate from that on the financial statements.

BC3.32H The IPSASB considered whether the Conceptual Framework should provide guidance on materiality considerations for regularity assertions/statements. Consistent with the reasoning in paragraph BC3.32, the IPSASB concluded that additional guidance is not justified.

~~*Cost-Benefit*~~ **Cost-Benefit**

BC3.33 Some respondents to the 2010 Exposure Draft expressed concern that the text of the proposed Conceptual Framework does not specify that entities cannot decide to depart from IPSASs on the basis of their own assessments of the costs and benefits of particular requirements of an IPSAS. The IPSASB is of the view that such specification is not necessary. This is because, as noted in paragraph 1.2 of ~~the Conceptual Framework~~ Chapter 1, *Role and Authority of the Conceptual Framework*, authoritative requirements relating to recognition, measurement, and presentation in GPFRs are specified in IPSASs. GPFRs are developed to provide information useful to users and requirements are prescribed by IPSASs only when the benefits to users of compliance with those requirements are assessed by the IPSASB to justify their costs. However, preparers may consider costs and benefits in, for example, determining whether to include in GPFRs disclosure of information in addition to that required by IPSASs.

BC3.34 Some respondents to the 2010 Exposure Draft also expressed concern that the proposed Conceptual Framework did not recognize that cost-benefit trade-offs may differ for different public sector entities. They ~~are~~ were of the view that acknowledgement of this ~~may~~ might provide a useful principle to be applied when considering differential reporting issues. The IPSASB ~~has~~ considered these matters and determined that the Conceptual Framework ~~will~~ should not deal with issues related to differential reporting, including whether the costs and benefits of particular requirements might differ for different entities.

BC3.35 In the process of developing an IPSAS or RPG, the IPSASB considers and seeks input on the likely costs and benefits of providing information in GPFRs of public sector entities. However, in some cases, it may not be possible for the IPSASB to identify and/or quantify all benefits that are likely to flow from, for example, the inclusion of a particular disclosure, including those that may be required because they are in the public interest, or other requirement in an IPSAS. In other cases, the IPSASB may be of the view that the benefits of a particular requirement may be marginal for users of GPFRs of some public sector entities. In applying the cost-benefit test to determine whether particular requirements should be included in an IPSAS in these circumstances, the IPSASB's deliberations may also include consideration of whether imposing such requirements on public sector entities is likely to involve undue cost and effort for the entities applying the requirements.

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IPSAS®

Conceptual Framework Update

Chapter 5, *Elements in Financial Statements*

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This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets IPSAS™ and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants® (IFAC®).

CHAPTER 5, ELEMENTS IN FINANCIAL STATEMENTS

CONTENTS

Paragraphs 5.8–5.10, 5.13, 5.14, 5.15, 5.17, and the headings above paragraphs 5.11, 5.15, 5.16 and 5.17 are amended. Paragraphs 5.6A, 5.6B, 5.7A–5.7G, 5.12A, 5.14A, 5.16A–5.16F, 5.17A, 5.27A–5.27J and headings above paragraphs 5.7A, 5.8, 5.27A, and 5.27I are added. Paragraphs 5.15A-5.15F and 5.17B-5.17D are relocated. Paragraphs 5.7, 5.16, 5.18–5.26, and the headings above 5.13, 5.15A, 5.18 and 5.23 are deleted. New text is underlined, relocated text is double underlined, and deleted text is struck through.

Introduction

Purpose of this Chapter

5.1 This Chapter defines the elements used in financial statements and provides further explanation about those definitions.

Elements and their Importance

5.2 Financial statements portray the financial effects of transactions and other events by grouping them into broad classes which share common economic characteristics. These broad classes are termed the elements of financial statements. Elements are the building blocks from which financial statements are constructed. These building blocks provide an initial point for recording, classifying and aggregating economic data and activity in a way that provides users with information that meets the objectives of financial reporting and achieves the qualitative characteristics of financial reporting while taking into account the constraints on information included in GPFRs.

5.3 The elements defined in this Chapter do not refer to the individual items that are recognized as a result of transactions and events. Sub-classifications of individual items within an element and aggregations of items are used to enhance the understandability of the financial statements. Presentation is addressed in Chapter 8, *Presentation in General Purpose Financial Reports*.

5.4 In some circumstances, to ensure that the financial statements provide information that is useful for a meaningful assessment of the financial performance and financial position of an entity, recognition of economic phenomena that are not captured by the elements as defined in this Chapter may be necessary. Consequently, the identification of the elements in this Chapter does not preclude IPSASs from requiring or allowing the recognition of resources or obligations that do not satisfy the definition of an element identified in this Chapter (hereafter referred to as “other resources” or “other obligations”) when necessary to better achieve the objectives of financial reporting.

Elements Defined

5.5 The elements that are defined in this Chapter are:

- Assets;
- Liabilities;
- Revenue;
- Expense;
- Ownership contributions; and
- Ownership distributions.

Assets

Definitions of an Asset and a Resource

5.6 An asset is:

A resource presently controlled by the entity as a result of ~~a~~ past events.

5.6A A resource is a right to either service potential or the capability to generate economic benefits, or a right to both.

5.6B This section discusses three components of these definitions:

Rights (paragraphs 5.7A-5.7G);

Service potential and economic benefits (paragraphs 5.8-5.10); and

Present control as a result of past events (paragraph 5.11-5.13).

5.7 ~~A resource is an item with service potential or the ability to generate economic benefits. Physical form is not a necessary condition of a resource. The service potential or ability to generate economic benefits can arise directly from the resource itself or arises from the rights to use the resource. Some resources embody an entity's rights to a variety of benefits including, for example, the right to:~~

- ~~Use the resource to provide services[6];~~
- ~~Use an external party's resources to provide services, for example;~~
- ~~Convert the resource into cash through its disposal;~~
- ~~Benefit from the resource's appreciation in value; or~~
- ~~Receive a stream of cash flows.~~ [Deleted]

Rights

5.7A Rights to service potential or to the capability to generate economic benefits take many forms, including:

(a) Rights that correspond to an obligation of another party (see paragraph 5.16C), for example:

(i) Rights to receive cash;

(ii) Rights to receive goods or services[1];

(iii) Rights to exchange resources with another party on favorable terms. Such rights include, for example, a forward contract to buy a resource on terms that are currently favorable; and

(iv) Rights to benefit from an obligation of another party to transfer a resource if a specified uncertain future event occurs (see paragraph 5.16A).

(b) Rights that do not correspond to an obligation of another party, for example:

(i) Rights over physical objects, such as property, plant and equipment or inventories. Examples of such rights are a right to use a physical object or a right to benefit from a leased object; and

(ii) Rights to use intellectual property.

5.7B Many rights are established by binding arrangement, legislation, or similar means. For example, an entity might obtain rights from owning or leasing a physical object, from owning a debt instrument

[1] Subsequent references to 'services' in the Conceptual Framework encompass 'goods' unless the context indicates otherwise.

~~[6]. References to "services" in the Conceptual Framework encompass goods.~~

such as a student loan, or from owning software or the right to use intellectual property. However, an entity might also obtain rights in other ways, for example:

(a) By acquiring or creating know-how that is not in the public domain, such as a traffic management plan; or

(b) Through an obligation of another party that arises because that other party has little or no realistic alternative to avoid a transfer of resources (see paragraph 5.15).

5.7C Some services—for example, employee services and services-in-kind—are received and immediately consumed. An entity's right to obtain the service potential or economic benefits produced by such services exists very briefly until the entity consumes the services.

5.7D Not all of an entity's rights are assets of that entity. To be assets of the entity, the rights must (i) have service potential or economic benefits beyond those available to all other parties (see paragraphs 5.8-5.10) and (ii) be controlled by the entity (see paragraphs 5.11-5.12A). Rights available to all parties without significant cost—for instance, rights of access to public goods, such as public rights of way over land, or know-how that is in the public domain—are typically not assets for the entities that hold these rights.

5.7E In principle, each of an entity's rights is a separate asset. However, for accounting purposes, related rights are often treated as a single unit of account that is a single asset (see paragraphs 5.26A–5.26J). For example, legal ownership of a physical object may give rise to several rights, including a right to:

(a) Use the object;

(b) Sell rights over the object; and

(c) Pledge rights over the object.

5.7F In many cases, the set of rights arising from legal ownership of a physical object is accounted for as a single asset. Conceptually, the resource is the set of rights, not the physical object. Nevertheless, describing the set of rights as the physical object will often provide a faithful representation of those rights in the most concise and understandable way.

5.7G The relationship between sovereign rights, resources and an asset is discussed in paragraph 5.13.

Service Potential and Economic Benefits

5.8 Service potential is the ~~capacity~~ capability of a resource to provide services that contribute to achieving the entity's objectives. Service potential enables an entity to achieve its objectives without necessarily generating cash flows.

5.9 Public sector assets that embody service potential may include recreational, heritage, community, defense and other assets ~~which~~ that are held by governments and other public sector entities, and which are used to provide services to third parties. Such services may be for collective or individual consumption. Many services may be provided in areas in which market competition is limited or non-existent. ~~where there is no market competition or limited market competition~~. The use and disposal of such assets may be restricted as many assets that embody service potential are specialized in nature.

5.10 Economic benefits are cash inflows or a reduction in cash outflows. Cash inflows (or reduced cash outflows) may be derived from, for example:

- An asset's use in the production and sale of services;
- The direct exchange of an asset for cash; ~~or other resources;~~ or
- Extinguishing or reducing a liability by transferring an asset.

Presently Controlled by the Entity as a Result of Past Events

5.11 An entity must have control of the resource. Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.

5.12 In assessing whether it presently controls a resource, an entity assesses whether the following indicators of control exist:

- Legal ownership;
- Access to the resource, or the ability to deny or restrict access to the resource;
- The means to ensure that the resource is used to achieve its objectives; and
- The existence of an enforceable right to service potential or the capability to generate economic benefits arising from a resource.

While these indicators are not conclusive determinants of whether control exists, identification and analysis of them can inform that decision.

5.12A Sometimes one party (a principal) engages another party (an agent) to act on behalf of, and for the benefit of, the principal. For example, a principal may engage an agent to arrange for the distribution of goods controlled by the principal to eligible beneficiaries. If an agent has custody of a resource controlled by the principal, that resource is not an asset of the agent.

~~**Past Event**~~

5.13 The definition of an asset requires that a resource that an entity presently controls must have arisen from ~~a~~ one or more past transactions or other past events. Past transactions or other events that result in an entity gaining control of a resource and therefore an asset may differ. Entities can obtain assets by purchasing them in an exchange transaction or developing them. Assets may also arise through non-exchange transactions, including through the exercising of sovereign powers. The power to tax or to issue licenses and to access or restrict or deny access to the benefits embodied in intangible resources, like the electromagnetic spectrum, are examples of public sector-specific powers and rights that may give rise to assets. In assessing when an entity's control of rights to resources arise, the following events may be considered: (a) a general ability to establish a power, (b) establishment of a power through a statute, (c) exercising the power to create a right, and (d) the event which gives rise to the right to receive resources from an external party. An asset arises when the power is exercised and the rights exist to receive resources.

Liabilities

Definition

5.14 A liability is:

A present obligation of the entity ~~for an outflow~~ to transfer ~~of~~ resources as a result of ~~that results from a~~ past events.

5.14A For a liability to exist, three criteria must all be satisfied:

(a) The entity has an obligation (paragraphs 5.15-5.15F);

(b) The obligation is to transfer resources (paragraphs 5.16A-5.16F); and

(c) The obligation is a present obligation arising from one or more past events (paragraphs 5.17-5.17D).

~~A Present~~ Obligations

5.15 Public sector entities can have a number of obligations. Obligations are binding when an entity has little or no realistic alternative to avoid them. ~~A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources.~~

~~Legal and Non-Legally Binding Obligations~~

5.15A Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations can arise from both exchange and non-exchange transactions. An obligation must be to an external party in order to give rise to a liability. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Identification of an external party is an indication of the existence of an obligation giving rise to a liability. However, it is not essential to know the identity of the external party before the time of settlement in order for ~~a present~~ an obligation and a liability to exist.

5.15B Many arrangements that give rise to an obligation include settlement dates. The inclusion of a settlement date may provide an indication that an obligation involves ~~an outflow~~ a transfer of resources and gives rise to a liability. However, there are many agreements that do not contain settlement dates. The absence of a settlement date does not preclude an obligation giving rise to a liability.

Legal Obligations

5.15C A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent authority or arrangements. There are jurisdictions where government and public sector entities cannot enter into legal obligations, because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in the Conceptual Framework. For some types of non-exchange transactions, judgment will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law, there can be no doubt that an entity has little or no realistic alternative to avoid the obligation and that a liability exists.

5.15D Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date, but will be enforceable with the passage of time without the external party having to meet further conditions— or having to take any further action—prior to settlement. Claims that are unconditionally enforceable subject to the passage of time are enforceable obligations in the context of the definition of a liability.

5.15E Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this Conceptual Framework. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.

Non-Legally Binding Obligations

5.15F. Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give rise to liabilities have the following attributes:

- The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
- As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
- The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

~~An Outflow of Resources~~ A Transfer of Resources from the Entity

5.16 ~~A liability must involve an outflow of resources from the entity for it to be settled. An obligation that can be settled without an outflow of resources from the entity is not a liability.~~ [Deleted]

5.16A To satisfy the definition of a liability the obligation must have the potential to require the entity to transfer resources to another party (or parties). For that potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer resources—the transfer may, for example, be required only if a specified uncertain future event occurs. It is only necessary that the present obligation exists, and that, at least in one circumstance, it would require the entity to transfer resources.

5.16B An obligation can meet the definition of a liability even if the probability of a transfer of resources is low. Nevertheless, that low probability might affect decisions about the information provided about the liability and how the information is provided. Chapter 6 provides guidance on recognition and Chapter 7 provides guidance on measurement.

5.16C Obligations to transfer resources include, for example:

(a) Obligations to pay cash;

(b) Obligations to provide services or deliver goods;

(c) Obligations to exchange resources with another party on unfavorable terms. Such obligations include, for example, a forward contract to sell on terms that are currently unfavorable or an option that entitles another party to purchase resources from the entity;

(d) Obligations to transfer resources if a specified uncertain future event occurs; and

(e) Obligations to issue a financial instrument if that financial instrument will oblige the entity to transfer a resource.

5.16D Instead of fulfilling an obligation to transfer resources to the party that has a right to receive resources, entities may in some circumstances:

(a) Settle the obligation by negotiating a release from the obligation;

Transfer the obligation to a third party; or

Replace the obligation to transfer resources with another obligation by entering into a new transaction.

5.16E In the situations identified in paragraph 5.16D an entity has an obligation to transfer resources until it has settled, transferred, or replaced that obligation.

5.16F In a principal-agent relationship (see paragraph 5.12A), if the agent has an obligation to transfer resources controlled by the principal to a third party, that obligation is not a liability of the agent. In such a case the resources that would be transferred are the principal's resources.

Present Obligation as a Result of Past Events

5.17 A present obligation is binding. To satisfy the definition of a liability, it is necessary that a present obligation arises as a result of one or more ~~a~~ past transactions ~~and~~ or other past events and has the potential to require the entity to ~~an outflow of resources~~ transfer resources from the entity. ~~The complexity of public sector programs and activities means that a number of events in the development, implementation and operation of a particular program may give rise to obligations. For financial reporting purposes it is necessary to determine whether such commitments and obligations, including binding obligations that the entity has little or no realistic alternative to avoid but are not legally enforceable (non-legally binding obligations) are present obligations and satisfy the definition of a liability. Where an arrangement has a legal form and is binding, such as a contract, the past event may be straightforward to identify. In other cases, it may be more difficult to identify the past event and identification involves an assessment of when an entity has little or no realistic alternative to avoid an outflow of resources from the entity. In making such an assessment an entity takes jurisdictional factors into account.~~

5.17A A present obligation exists as a result of past events only if:

(a) The entity has already obtained service potential or economic benefits or taken an action[2]; and

(b) As a consequence, the entity will or may have to transfer resources that it would not otherwise have had to transfer.

5.17B In the public sector, obligations may arise at a number of points. For example, in implementing a program or service:

- Making a political promise such as an electoral pledge;

[2] In the public sector a present obligation can arise from an obligation imposed by a higher level of government.

- Announcement of a policy;
- Introduction (and approval) of the budget (which may be two distinct points); and
- The budget becoming effective (in some jurisdictions the budget will not be effective until an appropriation has been effected).

The early stages of implementation are unlikely to give rise to present obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to present obligations that meet the definition of a liability. As noted in paragraph 5.15A an entity cannot be obligated to itself as a result of a public communication.

5.17C The point at which an obligation gives rise to a liability depends on the nature of the obligation. Factors that are likely to impact on judgments whether other parties can validly conclude that the obligation is such that the entity has little or no realistic alternative to avoid a transfer ~~an outflow~~ of resources include:

- The nature of the past event or events that give rise to the obligation. For example, a promise made in an election is unlikely to give rise to a present obligation because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it has little or no realistic alternative to avoid settling. However, an announcement in relation to an event or circumstance that has occurred may have such political support that the government has little option to withdraw. Where the government has committed to introduce and secure passage of the necessary budgetary provision such an announcement may give rise to a non-legally binding obligation;
- The ability of the entity to modify or change the obligation before it crystallizes. For example, the announcement of policy will generally not give rise to a non-legally binding obligation, which cannot be modified before being implemented. ~~Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before those events occur;~~ and
- There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, a non-legally binding obligation may exist. However, the absence of a budgetary provision does not itself mean that a present obligation has not arisen.

5.17D "Economic coercion," "political necessity" or other circumstances may give rise to situations where, although the public sector entity is not legally obliged to incur a transfer ~~an outflow~~ of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid a transfer of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.

~~Legal and Non-Legally Binding Obligations~~

5.18 ~~Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations can arise from both exchange and non-exchange transactions. An obligation must be to an external party in order to give rise to a liability. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Identification of an external party~~

~~is an indication of the existence of an obligation giving rise to a liability. However, it is not essential to know the identity of the external party before the time of settlement in order for a present obligation and a liability to exist.~~ [Deleted]

5.19 ~~Many arrangements that give rise to an obligation include settlement dates. The inclusion of a settlement date may provide an indication that an obligation involves an outflow of resources and gives rise to a liability. However, there are many agreements that do not contain settlement dates. The absence of a settlement date does not preclude an obligation giving rise to a liability.~~ [Deleted]

5.20 ~~A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent authority or arrangements. There are jurisdictions where government and public sector entities cannot enter into legal obligations, because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in the Conceptual Framework. For some types of non-exchange transactions, judgment will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law there can be no doubt that an entity has no realistic alternative to avoid the obligation and that a liability exists.~~ [Deleted]

5.21 ~~Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date but will be enforceable with the passage of time without the external party having to meet further conditions— or having to take any further action—prior to settlement. Claims that are unconditionally enforceable subject to the passage of time are enforceable obligations in the context of the definition of a liability.~~ [Deleted]

5.22 ~~Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this Framework. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.~~ [Deleted]

~~*Non-Legally Binding Obligations*~~

5.23 ~~Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give rise to liabilities have the following attributes:~~

- ~~The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;~~
- ~~As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and~~
- ~~The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.~~ [Deleted]

5.24 ~~In the public sector, obligations may arise at a number of points. For example, in implementing a program or service:~~

- ~~Making a political promise such as an electoral pledge;~~

- ~~Announcement of a policy;~~
- ~~Introduction (and approval) of the budget (which may be two distinct points); and~~
- ~~The budget becoming effective (in some jurisdictions the budget will not be effective until an appropriation has been effected).~~
- ~~The early stages of implementation are unlikely to give rise to present obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to obligations that meet the definition of a liability.~~ [Deleted]

5.25 ~~The point at which an obligation gives rise to a liability depends on the nature of the obligation. Factors that are likely to impact on judgments whether other parties can validly conclude that the obligation is such that the entity has little or no realistic alternative to avoid an outflow of resources include:~~

- ~~The nature of the past event or events that give rise to the obligation. For example, a promise made in an election is unlikely to give rise to a present obligation because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it has little or no realistic alternative to avoid settling. However, an announcement in relation to an event or circumstance that has occurred may have such political support that the government has little option to withdraw. Where the government has committed to introduce and secure passage of the necessary budgetary provision such an announcement may give rise to a non-legally binding obligation;~~
- ~~The ability of the entity to modify or change the obligation before it crystallizes. For example, the announcement of policy will generally not give rise to a non-legally binding obligation, which cannot be modified before being implemented. Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before those events occur; and~~
- ~~There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, a non-legally binding obligation may exist. However, the absence of a budgetary provision does not itself mean that a present obligation has not arisen.~~ [Deleted]

5.26 ~~"Economic coercion," "political necessity" or other circumstances may give rise to situations where, although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.~~ [Deleted]

Assets and Liabilities

Unit of Account

5.27A The unit of account is the right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations to which recognition criteria and measurement concepts are applied.

5.27B A unit of account is selected for an asset or liability when considering how recognition criteria and measurement concepts will apply to that asset or liability and to the related revenue and expense. In some circumstances it may be appropriate to select one unit of account for recognition and a different unit of account for measurement. For example, arrangements may sometimes be recognized individually but measured as part of a portfolio of binding arrangements. For presentation and disclosure, assets, liabilities, revenue and expense may need to be aggregated or separated into components.

5.27C If an entity transfers part of an asset or part of a liability, the unit of account may change at that time, so that the transferred component and the retained component become separate units of account.

5.27D A unit of account is selected to provide useful information, which implies that:

(a) The information provided about the asset or liability and about any related revenue and expense must be relevant. Treating a group of rights and obligations as a single unit of account may provide more relevant information than treating each right or obligation as a separate unit of account if, for example, those rights and obligations:

 (i) Cannot be or are unlikely to be the subject of separate transactions;

 (ii) Cannot or are unlikely to expire in different patterns;

 (iii) Have similar characteristics and risks; or

 (iv) Are used together in the operational activities conducted by an entity to provide services or to produce cash flows and are measured by reference to estimates of their interdependent service potential or future cash flows.

(b) Information provided about the asset or liability and about any related revenue or expense must faithfully represent the substance of a transaction or other event from which they have arisen. Therefore, it may be necessary to treat rights or obligations arising from different sources as a single unit of account, or to separate the rights or obligations arising from a single source. Equally, to provide a faithful representation of unrelated rights or obligations, it may be necessary to recognize and measure them separately.

5.27E In selecting a unit of account it is also important to consider the cost-benefit constraint of financial reporting discussed in Chapter 3. In general, the costs associated with recognizing and measuring assets, liabilities, revenue and expense increase as the size of unit of account decreases. Hence, in general, rights or obligations arising from the same source are separated only if the resulting information is more useful and the benefits outweigh the costs.

5.27F One example of rights and obligations arising from the same source are binding arrangements, which establish both rights and obligations for each of the parties. If those rights and obligations are interdependent and cannot be separated, they constitute a single inseparable asset or liability and hence form a single unit of account.

5.27G Conversely, if rights are separable from obligations arising from the same source, it may sometimes be appropriate to group the rights separately from the obligations, resulting in the identification of one or more separate assets and liabilities. In other cases, it may be more appropriate to group separable rights and obligations in a single unit of account, treating them as a single asset or a single liability.

5.27H Treating a set of rights and present obligations as a single unit of account differs from offsetting assets and liabilities. Offsetting occurs when an entity recognizes and measures both an asset and liability as separate units of account, but groups them into a single net amount in the statement of financial position. Offsetting classifies dissimilar items together and therefore is generally not appropriate.

Binding Arrangements that are Equally Unperformed

5.27I Some binding arrangements, or portions of binding arrangements, may be equally unperformed whereby neither party has fulfilled any of its obligations or both parties have partially fulfilled their obligations to an equal extent. Such binding arrangements establish a combined right and obligation to exchange resources. The right and obligation are interdependent and cannot be separated. Hence the combined right and obligation constitute a single asset or liability. The entity has an asset if the terms of the exchange are currently favorable; it has a liability if the terms of the exchange are currently unfavorable. Whether such an asset or liability is included in the financial statements depends on both the recognition criteria (see Chapter 6) and the measurement basis selected for the asset and liability (see Chapter 7).

5.27J To the extent that either party fulfills its obligations under the binding arrangement, the binding arrangement changes character. If the reporting entity performs first under the binding arrangement, that performance is the event that changes the reporting entity's right and obligation to exchange resources into a right to receive a resource. That right is an asset. If the other party performs first, that performance is the event that changes the reporting entity's right and obligation to exchange resources into an obligation to transfer a resource. That obligation is a liability.

Net Financial Position, Other Resources, and Other Obligations

5.28 As explained in paragraph 5.4, in some cases, in developing or revising an IPSAS, the IPSASB may determine that to achieve the objectives of financial reporting a resource or obligation that does not satisfy the definition of an element defined in the Conceptual Framework needs to be recognized in the financial statements. In these cases, the IPSAS may require or allow these resources or obligations to be recognized as other resources or other obligations, which are items additional to the six elements defined in this Conceptual Framework.

5.29 Net financial position is the difference between assets and liabilities after adding other resources and deducting other obligations recognized in the statement of financial position. Net financial position can be a positive or negative residual amount.

Revenue and Expense

Definitions

5.30 Revenue is:

Increases in the net financial position of the entity, other than increases arising from ownership contributions.

5.31 Expense is:

Decreases in the net financial position of the entity, other than decreases arising from ownership distributions.

5.32 Revenue and expense arise from exchange and non-exchange transactions, other events such as unrealized increases and decreases in the value of assets and liabilities, and the consumption of assets through depreciation and erosion of service potential and ~~ability~~ capability to generate economic benefits through impairments. Revenue and expense may arise from individual transactions or groups of transactions.

Surplus or Deficit for the Period

5.33 The entity's surplus or deficit for the period is the difference between revenue and expense reported on the statement of financial performance.

Ownership Contributions and Ownership Distributions

Definitions

5.34 Ownership contributions are:

Inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity.

5.35 Ownership distributions are:

Outflows of resources from the entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the net financial position of the entity.

5.36 It is important to distinguish inflows of resources from owners, including those inflows that initially establish the ownership interest, and outflows of resources to owners in their capacity as owners from revenue and expense. In addition to the injections of resources and the payment of dividends that may occur, in some jurisdictions it is relatively common for assets and liabilities to be transferred between public sector entities. Where such transfers satisfy the definitions of ownership contributions or ownership distributions they will be accounted for as such.

5.37 Ownership interests may arise on the creation of an entity when another entity contributes resources to provide the new entity with the capacity to commence operational activities. In the public sector, contributions to, and distributions from, entities are sometimes linked to the restructuring of government and will take the form of transfers of assets and liabilities rather than cash transactions. Ownership interests may take different forms, which may not be evidenced by an equity instrument.

5.38 Ownership contributions may take the form of an initial injection of resources at the creation of an entity or a subsequent injection of resources, including those where an entity is restructured. Ownership distributions may be: (a) a return on investment; (b) a full or partial return of investment; or (c) in the event of the entity being wound up or restructured, a return of any residual resources.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

Scope of Chapter

BC5.1 Respondents to the 2010 Consultation Paper, *Elements and Recognition in Financial Statements* (the 2010 Consultation Paper), questioned why the IPSASB was only addressing elements for the financial statements in this phase of the Conceptual Framework. They suggested that IPSASB should also develop elements for economic and other phenomena in the more comprehensive areas of financial reporting outside the financial statements. The IPSASB acknowledges the merits of these views and the need to develop such elements in the future. However, the IPSASB decided that in order to put its future standard-setting activities for the financial statements on a sound and transparent footing it is important to deal firstly with the development of elements for the financial statements.

BC5.2 The IPSASB acknowledges a view that cash inflows and cash outflows should be defined as elements of the cash flow statement. The IPSASB took the view that cash inflows and cash outflows are components of the elements identified in this Chapter, and that further guidance should be provided at standards level.

Limited Scope Update of Conceptual Framework

BC5.2A In March 2020 the IPSASB initiated a Limited Scope Update of the Conceptual Framework. The Limited Scope Update compared the definitions of an asset and a liability with the definitions in the IASB's Conceptual Framework, which was finalized in 2018 (IASB 2018 Conceptual Framework). The guidance supporting the definitions was also reviewed to take account of experience in applying the Conceptual Framework in standards development and maintenance.

BC5.2B The Limited Scope Update also evaluated the case for including guidance on the unit of account and binding arrangements that are equally unperformed. The 2014 Conceptual Framework did not address these issues. The IPSASB approved an updated Chapter 5 in March 2023. The IPSASB started using updated Chapter 5 immediately once approved.

Assets

The Definition of an Asset

BC5.2C The definition of an asset in the 2014 Conceptual Framework was:

A resource presently controlled by the entity as a result of a past event.

BC5.2D The definition of an asset in the IASB's 2018 Conceptual Framework is:

A present economic resource controlled by the entity as a result of past events.

BC5.2E Neither the IPSASB nor the IASB definitions included wording that could be interpreted as recognition thresholds, such as "expected to flow".

BC5.2F The 2014 IPSASB and 2018 IASB definitions contain the same components—a resource/an economic resource; control; and a past event/past events. The only differences were:

(a) The IASB uses the term "economic resource", whereas the IPSASB uses the term 'resource'.

(b) The IASB attaches "present" to "economic resource", whereas the IPSASB Conceptual Framework attaches "presently" to control. The IASB's use of "present economic resource" mirrors a present obligation for a liability.

(c) The IASB uses "past events" (plural). The IPSASB used "past event" (singular). The IPSASB formulation was intended to indicate that there need be only one past event in order for the definition of an asset to be met.

BC5.2G The IPSASB considered the rationale for using the terms "resource" and "presently controlled". The IPSASB considers that a resource is inherently economic and that the use of "economic resource" might be confused with "economic benefits", because of the guidance that rights with service potential are resources as well as those with the capability to generate economic benefits. The term "presently controlled" reinforces the key point that control of a resource must be evaluated at the reporting date, rather than in the future. The prospect of control in the future is not sufficient to meet the asset definition. The IPSASB therefore reaffirmed the use and location of these terms.

BC5.2H The IPSASB considered that the use of the plural "past events" rather than the singular "past event" better conveys the point that resources can accumulate over time due to an initial past event and further past events. An example is a binding arrangement for the delivery of services to third party beneficiaries in which one party receives resources from another party in order to finance the arrangement. The resource recipient accumulates assets as it incurs eligible expenditure or completes specified activities in accordance with the binding arrangement. The term "past events" includes the scenario where a single past event gives rise to an asset.

BC5.2I The revised definition of an asset is therefore:

A resource presently controlled by the entity as a result of past events.

BC5.2J In the Limited Scope Update the IPSASB reviewed the sequencing of guidance and restructured the guidance so that it reflected the components of the definition of an asset more clearly.

A Resource

BC5.3 The 2014 Conceptual Framework provided guidance that 'a resource provides benefits to an entity in the form of service potential or the ability to generate economic benefits or both. In reaching its conclusions on the nature of a resource the IPSASB considered whether the benefits of the resource must have already flowed to an entity in order for a resource to exist. However, the IPSASB concluded that resources themselves embody benefits—benefits that can be accessed by the entity that controls the rights to these benefits. The IPSASB also considered the nature of the benefits (see paragraph~~s~~ BC5.7 and BC5.8) and control (see paragraphs BC5.9–BC5.14).

BC5.3A The 2014 Conceptual Framework made a distinction between (i) service potential and the ability[3] to generate economic benefits that ~~can~~ arise directly from legal ownership of the resource and

[3] In the updated Conceptual Framework, the IPSASB uses the phrase 'capability to generate economic benefits', rather than 'ability to generate economic benefits'.

(ii) service potential and the capability to generate economic benefits that arise from other rights to use the resource.

BC5.3B The IASB 2018 Conceptual Framework considered but decided not to make the distinction outlined in paragraph BC5.3A. The IASB took the view that "ownership of a physical object arises because of rights conferred by law and that, although they differ in extent, the rights conferred by full legal ownership of a physical object and by a contract to use an object for 99% (or 50% or even 1%) of its useful life are all rights of one kind or another". The IASB also considered that there may be inconsistencies of what constitutes legal ownership in different jurisdictions or at different dates. In summary, the IASB guidance reflects a view that legal ownership is a particular form of right rather than a separate phenomenon.

BC5.3C The IPSASB acknowledged the view that physical ownership gives rise to a specific type of control and that this should be reflected conceptually. According to this view, from an accountability perspective, a conceptual approach, which might lead to underlying assets not being recognized as a single unit of account, risks not meeting the qualitative characteristic of understandability.

BC5.3D However, on balance, the IPSASB decided to adopt a more overtly rights-based approach. In particular, the IPSASB concluded that the view that legal ownership is a type of right rather than a separate phenomenon was persuasive.

BC5.3E The IASB 2018 Conceptual Framework acknowledged that in many cases, the set of rights arising from legal ownership of a physical object is accounted for as a single asset. The IPSASB inserted paragraph 5.7F providing guidance that describing the set of rights as the physical item will often provide a faithful representation of those rights in the most concise and understandable way.

BC5.3F The IPSASB considered whether it should augment the guidance on a resource with guidance drawn from the IASB 2018 Conceptual Framework. The IPSASB decided that the following guidance should be added on issues on which the 2014 Conceptual Framework had previously been silent:

- Rights can be classified as those that correspond to an obligation of another party and those that do not correspond to an obligation of another party (paragraph 5.7A).
- Ways in which rights can be established (paragraph 5.7B).
- When services are received and immediately consumed, an entity's right to obtain the service potential or/and economic benefits produced by such services exists very briefly until the entity consumes the services. This is consistent with the approach to services in-kind at the standards level where certain services in-kind are received as an asset and immediately consumed (paragraph 5.7C).
- Not all rights are assets of an entity (paragraph 5.7D).
- In principle each of an entity's rights is a separate asset (paragraph 5.7E).
- In many cases, the set of rights arising from legal ownership of a physical object is accounted for as a single asset (paragraph 5.7F; also noted above in paragraph BC5.3E).

BC5.3G Some respondents to Exposure Draft 81 opposed the more overtly rights-based approach. In particular, they disagreed with the potential non-recognition of physical assets in their entirety in the financial statements. They considered that this undermines accountability.

BC5.3H The IPSASB acknowledged this point. Paragraphs 5.7E and 5.7F state related rights are often treated as a single unit of account that is a single asset and that, in many cases, the set of rights arising from legal ownership of a physical object is accounted for as a single asset. There may be cases where different entities have different rights over an asset. In the IPSASB's view the economics of such arrangements should be reflected in the accounting.

Unconditional Rights ~~and Executory Contracts~~

BC5.4 Unconditional rights to resources typically result from ~~contracts or other~~ binding arrangements that require provision of resources to the entity in the future. The IPSASB notes that there can be a large number of such rights and acknowledged that unconditional rights that represent service potential or the capability to generate economic benefits that are controlled by the entity as a result of ~~a~~ past events give rise to assets. Whether such assets are recognized depends on whether the recognition criteria have been satisfied. The IPSASB concluded that the consequences of application of the definition of an asset to unconditional rights should be addressed at standards level.

BC5.5 ~~Executory contracts are binding arrangements where there is an unconditional right to receive resources and an equal present obligation to transfer resources to the counterparty in the future. Public sector entities are likely to engage in a large number of such arrangements. The IPSASB acknowledges the view that such arrangements may give rise to both assets and liabilities, as there is a right to receive resources and a present obligation to sacrifice resources, which the entity has no realistic alternative to avoid.~~ [Deleted]

BC5.6 ~~The IPSASB also acknowledges the view that recognizing assets and liabilities from executory contracts would involve the inclusion of potentially very large amounts of assets and liabilities in the statement of financial position and the statement of financial performance and that this may conflict with the qualitative characteristic of understandability. Whether assets and liabilities arise from rights and obligations in executory contracts will be determined by an assessment of whether those rights and obligations satisfy the definitions of elements and recognition criteria identified in the Conceptual Framework. Such assessments, and the approach to presentation in the financial statements of any elements arising from executory contracts, are considered at standards level.~~ [Deleted]

Service Potential and Economic Benefits

BC5.7 The term "service potential" has been used to identify the capability ~~capacity~~ of an asset to provide services in accordance with an entity's objectives. The term "economic benefits" has been used to reflect the capability ~~ability~~ of an asset to generate net cash inflows. Some argue that economic benefits include service potential. Others argue that service potential includes economic benefits—a further view is that the terms can be used interchangeably. The IPSASB considered whether the explanation of a resource should include a reference to both service potential and the ~~ability~~ capability to generate economic benefits.

BC5.8 The IPSASB noted that many respondents to the 2010 Consultation Paper and 2012 Exposure Draft, *Elements and Recognition in Financial Statements,* supported inclusion of a specific reference to service potential as a characteristic of an asset, because of the service delivery objectives of most public sector entities. The IPSASB therefore concluded that the explanation of a resource should include both the terms "service potential" and "economic benefits". This approach acknowledges that the primary objective of most public sector entities is to deliver services, but also that public sector entities may carry out activities with the sole objective of generating net cash inflows.

BC5.8A In the Limited Scope Update the IPSASB reaffirmed the term "service potential" as an attribute of a resource. In the description of service potential in paragraph 5.8, the IPSASB changed the wording "the capacity to provide services" to "the capability to provide services", because of the ambiguity of "capacity". Capacity has the same meaning of ability, but in other usages can mean the adequacy, availability and volume of resources. The IPSASB acknowledged that in many languages "capacity" and "capability" will translate similarly. In addition, the IPSASB made a modification to the wording of economic benefits in the description of a resource in paragraph 5.8 and acknowledged that an item can have both service potential and the capability to generate economic benefits. Guidance on the treatment of such assets is provided at the standards level.

Control

BC5.9 The IPSASB considered whether control is an essential characteristic of an asset or whether other indicators should be identified as essential characteristics of an asset including:

- Legal ownership;
- The right to access, and to restrict or deny the access of external parties to, the resource;
- The means to ensure that the resources are used to achieve the entity's objectives; and
- The existence of enforceable rights to service potential or economic benefits arising from a resource.

The IPSASB acknowledges the views of those who argue that control may be difficult to apply in some cases because it requires judgment to assess whether control exists. In addition, control can be erroneously applied to a resource in its entirety and not to the individual benefits that accrue from the resource. However, notwithstanding such difficulties, the IPSASB concluded that control is an essential characteristic of an asset because the presence of control facilitates the association of an asset with a specific entity.

BC5.10 Legal ownership of a resource, such as a property or item of equipment, is one method of accessing the service potential or economic benefits of an asset. However, rights to service potential or the ~~ability~~ capability to generate economic benefits may exist without legal ownership of the underlying resource. For example, the rights to service potential or the ~~ability~~ capability to generate economic benefits through the holding and use of leased property are accessed without legal ownership of the leased asset itself. Therefore, legal ownership of the resource is not an essential characteristic of an asset. Legal ownership is, however, an indicator of control.

BC5.11 The right to access a resource may give an entity the ability to determine whether to:

- Directly use the resource's service potential to provide services to beneficiaries;
- Exchange the resource for another asset, such as cash; or
- Use the asset in any of the other ways that may provide services or generate economic benefits.

BC5.12 While access to a resource is crucial, there are resources to which an entity has access which do not give rise to assets, such as air. Therefore, the ability to access a resource must be supplemented by the ability to deny or restrict the access of others to that resource—for example,

(a) an entity might decide whether to set an entrance fee to a museum and restrict access to those who do not pay the fee, and (b) government may control a natural resource under its land to which it can restrict the access of others. Legally enforceable claims to specific resources, such as a right of access to a road or a right to explore land for mineral deposits, could represent an asset to the holder. However, an entity may be able to access the service potential or ~~ability~~ capability to generate economic benefits associated with a resource in ways that do not require legal rights. The IPSASB took the view that the factors identified in paragraph BC5.9 are likely to be indicators of the existence of control rather than essential characteristics of the definition of an asset.

BC5.13 The IPSASB also considered whether the economic ownership approach is a viable alternative to the control approach. The economic ownership approach focuses on an entity's exposure to the underlying economic attributes that contribute to an asset's value to the entity. Some respondents to the 2012 Exposure Draft, ~~*Elements and Recognition in Financial Statements*,~~ in supporting the control approach, commented on the complexity of the economic ownership approach. The IPSASB concluded that the economic ownership approach is subjective and difficult to operate, and therefore rejected this approach.

BC5.14 The IPSASB considered whether an analysis of exposure to the risks and rewards of ownership is a useful indicator of control. The control approach focuses on the power of the entity to direct how the resource is used in order to benefit from the service potential and/or ~~ability~~ capability to generate economic benefits embodied in the resource. The risks and rewards approach focuses on an entity's exposure to the underlying economic attributes that contribute to an asset's value to the entity and the related risks. Consideration of the risks and rewards associated with particular transactions and events, and which party to any transaction or event bears the majority of those risks and rewards, may be relevant and useful in identifying the nature of the asset controlled by parties to the transaction or event. It may also be useful in determining how to quantify and associate the economic rights and obligations with particular parties. However, it is not of itself an indicator of the party that controls an asset. The IPSASB therefore decided not to include the risks and rewards of ownership as an indicator of control.

BC5.14A In the Limited Scope Update the IPSASB noted that the IASB 2018 Conceptual Framework included guidance on the principal-agent relationship. The 2014 IPSASB Conceptual Framework did not include guidance that in principal-agent relationships custody of a resource controlled by a principal does not give rise to an asset of the agent. While this is implicit in paragraph 5.11, the IPSASB considered that explicit guidance would be useful to underpin standards-level guidance and has therefore inserted a new paragraph 5.12A. The IPSASB included equivalent guidance for liabilities in paragraph 5.16F.

Past Events

BC5.15 Some respondents to the 2010 Consultation Paper and 2012 Exposure Draft argued that identification of a past transaction or other event which gives rise to the asset should be an essential characteristic of the definition of an asset. Others take the view that the identification of one or more past events is not necessary and should not therefore be an essential characteristic. They consider that such a requirement places undue emphasis on identifying the past event that gave rise to an asset. Such emphasis may be a distraction and lead to debates about which event is the triggering event instead of the more important issue of whether rights to resources exist at the reporting date. Those who take this view consider that the essential characteristic of an asset should be the existence of a resource. Some may accept that one or more a past events provides useful supporting evidence of the existence of an asset, but not that it should be an essential characteristic.

BC5.16 Many respondents took the view that a past event should be identified as an essential characteristic of the definition of an asset. The IPSASB agrees with these respondents—in particular, that the complex nature of many public sector programs and activities means that there are a number of points at which control of a resource might arise. Therefore, the IPSASB concluded that identification of the appropriate past event is crucial in identifying whether an asset exists.

BC5.17 The powers and rights of government are particularly significant for the identification of assets. The power to tax and issue licenses, and other powers to access or to deny or restrict access to the benefits embodied in intangible resources like the electromagnetic spectrum, are examples of sovereign powers. It is often difficult to determine when such powers give rise to a right that is a resource and asset of the entity.

BC5.18 A government's power to establish a right to levy a tax or fee, for example, often begins a sequence of events that ultimately results in the flow of economic benefits to the government. The IPSASB considered two views of when an asset arises from the powers and rights of government to levy a tax or fee. The first view is that the government has an inherent power to tax at every reporting date and, therefore, that the general ability to levy taxes or fees is an asset. Proponents of this view accept that such an asset is unlikely to be capable of faithfully representative measurement but argue that this should not deflect from an acknowledgement that government has a perpetual asset. The contrary view is that the power to levy taxes and fees must be converted into a right by legal means, and that such a right must be exercised or exercisable in order for an asset to come into existence. Many respondents to the 2010 Consultation Paper and 2012 Exposure Draft supported this latter view. The IPSASB agrees with these respondents. In particular, the IPSASB concluded that a government's inherent powers do not give rise to assets until these powers are exercised and the rights exist to receive service potential or economic benefits. The updated definition of an asset and supporting guidance does not affect either the discussion of sovereign powers and rights or the key principle that an asset arises when the power is exercised, and the rights exist to receive resources.

Liabilities

BC5.18A The definition of a liability in the 2014 Conceptual Framework was:

A present obligation of the entity for an outflow of resources that results from a past event.

BC5.18B The definition of a liability in the IASB's 2018 Conceptual Framework is:

A present obligation of the entity to transfer an economic resource as a result of past events.

BC5.18C As for the asset definition (see above paragraphs BC5.2A-BC5.2J) both IPSASB and IASB definitions contained the same or similar components—resources/an economic resource; outflow of resources/transfer of resources; and a past event/past events. The differences were:

(a) As in the asset definitions, the IASB uses the term "economic resource", whereas the IPSASB uses the term "resource". The IPSASB's reason for retaining the term "resource" is discussed in paragraph BC5.2G.

(b) The IASB definition replaced the term "outflow of resources" with "transfer of an economic resource". This was largely because of the linkage of the term an outflow of resources with the expectation of such an outflow and therefore potential confusion with a recognition threshold.

(c) As in the asset definition, the IASB uses "past events" (plural). The IPSASB used "past event" (singular). The IPSASB formulation was intended to indicate that there need be only one past event in order for the definition to be met.

BC5.18D The IPSASB was persuaded by the adoption of the term transfer of resources and considered the standards-level implications of the adoption of the term "transfer of resources" in the revised definition of a liability at the standards-level.

BC5.18E The IPSASB noted that the term "transfers" is defined in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. A project to replace IPSAS 23 was underway at the time that the Limited Scope Update took place. The IPSASB concluded that any ambiguities or inconsistencies between conceptual and standards levels could be mitigated by adjustments to new defined terms and the provision of guidance on what a transfer of resources involves. Such guidance is in paragraphs 5.16A-5.16E.

BC5.18F Consistent with the analysis for assets at BC5.2H the IPSASB considered that the use of the plural "past events" rather than the singular "past event" better conveys that present obligations that give rise to liabilities can accumulate over time due to an initial past event and further past events.

BC5.18G The revised definition of a liability is:

A present obligation of the entity to transfer resources as a result of past events.

BC5.18H Most respondents to Exposure Draft 81 supported the revised definition. Some respondents expressed unease about the term 'transfer of resources', which they felt had particular public sector connotations. The IPSASB felt that such reservations could be allayed through clear supporting guidance (see below paragraph BC 5.19F). The IPSASB therefore decided to adopt this definition in the revised Chapter 5.

BC5.18I Similarly to the guidance on assets, the IPSASB considered the sequencing of guidance on liabilities and restructured the guidance so that it reflected the components of the definition of a liability more clearly. The revised structure also drew on the approach in the IASB's 2018 Conceptual Framework in describing the characteristics of an obligation more clearly and linking a present obligation to a past event. This necessitated a relocation of guidance. The revised guidance is in paragraphs 5.14A-5.17D.

BC5.18J There was strong support for the restructuring of the guidance on liabilities. No new issues arose from the consultation. The IPSASB therefore decided to adopt the restructured guidance in the revised Chapter 5.

A Present Obligation

BC5.19 In considering when obligations are present obligations, the IPSASB accepts that a legal obligation gives rise to a present obligation. In some jurisdictions, public sector entities are not permitted to enter into certain legal arrangements, but there are equivalent mechanisms that give rise to a present obligation. Such mechanisms are considered legally binding. The IPSASB then considered how to classify obligations that are not legal obligations. The IPSASB noted that "constructive obligation" is a term embedded in standard-setting literature globally and has been used in IPSASs. However, it has proved difficult to interpret and apply in a public sector context. Therefore, the IPSASB considered alternative terminology, for example the term "a social or moral duty or requirement." The IPSASB has concerns that the term "social" might be confused with political values and that the term "moral obligations" risks a perception that standard setters and preparers are arbiters of morality. Therefore, the IPSASB decided that making a distinction between "legally binding" and "non-legally binding obligations" is the most straightforward and understandable approach. The IPSASB considered and rejected the view that the term "non-legally binding obligations" might be interpreted as referring to obligations, the legality of which is questionable. Paragraphs BC5.30–BC5.34 discuss non-legally binding obligations and explain their meaning for the purposes of the Conceptual Framework.

A Transfer of Resources

BC5.19A The guidance on "an outflow of resources from the entity" in the 2014 Conceptual Framework was limited to statements that "a liability must involve an outflow of resources from the entity for it to be settled" and that "an obligation that can be settled without an outflow of resources from the entity is not a liability".

BC5.19B In IPSASB's Revenue project some constituents indicated that ED 71, *Revenue without Performance Obligations,* was not clear on what gives rise to a liability in a binding arrangement. It became evident that this lack of clarity was partly attributable to uncertainty over what constitutes an outflow of resources from the entity.

BC5.19C The IPSASB noted that the IASB 2018 Conceptual Framework includes guidance on the application of a transfer of resources. With appropriate changes for public sector terminology, this guidance has been added in paragraphs 5.16A-5.16E of Chapter 5:

(a) Paragraph 5.16A states that the obligation must have the potential to require the entity to transfer a resource to another party or parties. The transfer does not have to be certain or even likely and might be dependent on a specified uncertain future event occurring.

(b) Paragraph 5.16B states that an obligation can meet the definition of a liability even if the probability of a transfer of a resource is low.

(c) Paragraph 5.16C provides examples of obligations to transfer a resource.

(d) Paragraph 5.16D indicates that rather than fulfill an obligation to transfer a resource to another party, entities may sometimes negotiate release from the obligation, transfer the obligation to a third party or replace the obligation with another obligation by entering into a new transaction. This paragraph reflects that in the public sector an entity's ability to extinguish or reduce a present obligation other than by fulfillment may be limited.

(e) Paragraph 5.16E states that in the situations described in paragraph 5.16D an entity has an obligation to transfer a resource until it has negotiated release from the obligation, transferred the obligation, or replaced the obligation.

BC5.19D The IPSASB emphasized that the ability to extinguish or reduce a present obligation by methods other than fulfillment does not mean that an entity has a realistic alternative of avoiding a transfer of resources and therefore a rationale for non-recognition of a present obligation as a liability, which otherwise meets recognition criteria.

BC5.19E The 2014 Conceptual Framework included guidance that "if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before these events occur". The IPSASB has deleted this guidance because it was inconsistent with the statement in paragraph 5.16A. that "to satisfy the definition of a liability the obligation must have the potential to require the entity to transfer resources to another party (or parties)".

BC5.19F The majority of respondents to ED 81 supported the enhanced guidance on "the transfer of resources". Some respondents felt that the term "transfers" has a particular connotation in the public sector, denoting transfers between different levels of government and transfers to individuals and households. They felt that there might be confusion between the broader usage in the Conceptual Framework and requirements and guidance at the standards level. The IPSASB acknowledged this point but felt that any confusion could be minimized by the use of clearly defined terms at the standards level.

BC5.19G A view was expressed in the consultation response that the Conceptual Framework should provide guidance on obligations related to the Treasury Single Account. The Treasury Single Account is an account or a set of linked accounts through which receipts and payments are transacted for all government departments. The IPSASB acknowledged that the Treasury Single Account is an important mechanism for central government financial administration in many jurisdictions. However, the IPSASB considered that the operation of the Treasury Single Account is too low-level a topic to be addressed in the Conceptual Framework.

Conditional and Unconditional Obligations

BC5.20 In the context of a present obligation, the IPSASB considered whether "conditional" and "unconditional" obligations, "stand-ready obligations" and "performance obligations" might be present obligations.

BC5.21 An unconditional obligation is one that stands on its own, independent of future events. Unconditional obligations give rise to liabilities if the definition of a liability is satisfied. A conditional obligation involves the possible occurrence of a future event, which may or may not be under the control of the reporting entity. The IPSASB concluded that it is possible for conditional obligations to give rise to liabilities as defined in the Conceptual Framework. Determining whether a conditional obligation satisfies the definition of a liability will involve consideration of the nature of the obligation and the circumstances in which it has arisen. Given the complexity of public sector programs and activities, identifying the past event (or events), which has (have) resulted in the entity having little or no realistic alternative to avoid an outflow of resources, often may not be straightforward. Guidance on whether conditional obligations that exist in particular arrangements or circumstances may give rise to liabilities consistent with the definitions identified in the Conceptual Framework is a standards-level issue.

BC5.22 A variety of terms are used to describe present obligations that may arise from, or exist in conjunction with, conditional obligations in particular circumstances. Amongst these are stand ready-obligations and performance obligations. The characteristics of these obligations and the conclusions reached by the IPSASB in the context of the Conceptual Framework are outlined below.

Stand-Ready Obligations

BC5.23 Stand-ready obligations are a type of conditional obligation. Stand-ready obligations require an entity to be prepared to fulfill an obligation if a specified uncertain future event outside the entity's control occurs (or fails to occur). The term stand-ready obligation is used to describe a liability that may arise in certain contractual circumstances, such as those related to insurance, certain financial instruments such as a derivative contract in a loss position, and for warranties where the entity has an obligation to transfer resources if a specified future event occurs (or does not occur). In such circumstances, there may be an identifiable past event and an outflow of resources from the entity, although the exact identity of the party to whom settlement will be made will not generally be known.

BC5.24 The 2010 Consultation Paper included a discussion of stand-ready obligations. Many respondents found the distinction between a stand-ready obligation and other conditional obligations ambiguous. The 2012 Exposure Draft explained that the term stand-ready obligation is not widely used in the public sector, and does not work well in certain public sector circumstances, and suggested that whether a stand-ready obligation gave rise to a liability is a standards-level issue. Some respondents did not agree with the explanation in the 2012 Exposure Draft, and expressed a view that the Conceptual Framework should provide guidance for use at the standards level on whether stand-ready obligations can give rise to liabilities in certain circumstances.

BC5.25 A public sector entity's obligation to transfer resources to another entity in particular circumstances that may occur in the future includes, for example, as a potential lender of last resort and in support of programs that provide a wide range of social benefits. The existence of an obligation to transfer resources to another party in these circumstances may be dependent on ongoing satisfaction of a number of conditions of differing significance and nature that are subject to change by the government or public sector entity. The IPSASB is of the view that the circumstances in which liabilities arise as a consequence of the obligation of a public sector entity to transfer resources to other parties consistent with the terms of programs, and how such liabilities should be described and accounted for, should be considered at the standards level consistent with the principles established in the Conceptual Framework. The IPSASB decided that the Conceptual Framework should not resolve whether all obligations that might be classified as stand-ready meet the definition of a liability. The IPSASB also decided not to use the term "stand-ready obligation" in the Conceptual Framework.

Performance Obligations

BC5.26 A performance obligation is an obligation in a contract or other binding arrangement between an entity and an external party to transfer a resource to that other party. Performance obligations are often explicitly stated in a contract or other arrangement. Not all performance obligations are explicit. For example, a statutory requirement may give rise to an implicit performance obligation of a public sector entity that is additional to the terms of an agreement or contract.

BC5.27 A performance obligation also arises when an entity enters into an arrangement whereby it receives a fee and, in return, provides an external party with access to an asset of the government. The IPSASB concluded that it is not necessary to identify a specific external party for a performance obligation to arise, but it is important to analyze such obligations in order to determine whether they include a requirement to provide an outflow for a transfer of resources. Obligations that require an entity to provide access to a resource, but do not entail ~~an outflow~~ a transfer of resources do not give rise to liabilities. However, obligations that require an entity to forgo future resources may be liabilities. Performance obligations are often conditional obligations. Determining whether such obligations give rise to liabilities is dependent upon the terms of particular binding agreements and may vary between jurisdictions. The IPSASB concluded that the circumstances under which performance obligations give rise to liabilities should be considered at the standards level.

Past Events

BC5.28 The IPSASB considered whether the definition of a liability should require the existence of a past transaction or other event. Some take the view that identification of a past event is not an essential characteristic of a liability, and that, consequently, there is no need for the definition of a liability to include a reference to a past event. These commentators argue that there may be many possible past events and that establishing the key past event is likely to be arbitrary. They suggest that the identification of a past event is not a primary factor in determining whether a liability exists at the reporting date. This view mirrors the opposition to the inclusion of a past event in the definition of an asset, which is discussed in paragraphs BC5.15–BC5.18.

BC5.29 The IPSASB acknowledges this view, but also noted that many respondents to the 2010 Consultation Paper and 2012 Exposure Draft consider that a past event is a characteristic of a liability. The IPSASB agrees with the view that the complexity of many public sector programs and activities and the number of potential points at which a present obligation might arise means that, although challenging, identification of the past event that gives rise to a liability is critical in determining when public sector liabilities should be recognized. The IPSASB reconsidered whether the definition of a liability should include a reference to past event(s) in the Limited Scope Update in 2020. The IPSASB reaffirmed the importance of past events and linked past events to present obligations.

An Incremental Transfer of Resources as a Result of Past Events

BC5.29A In developing proposals on revenue, the IPSASB acknowledged that the transfer of resources arising from a binding arrangement must be incremental in order to give rise to a liability. Paragraph 4.43 of the IASB 2018 Conceptual Framework provides guidance that the concept "as a result of past events" means that:

(a) An entity has already obtained economic benefits or taken an action; and

(b) As a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer.

BC5.29B This guidance establishes a principle that, in order to meet the definition of a liability, the past events must give rise to an incremental transfer of resources. An obligation, which can be fulfilled without an incremental transfer of resources, is not a present obligation and does not meet the definition of a liability.

Little or No Realistic Alternative to Avoid.

BC5.30 Some respondents to the 2012 Exposure Draft expressed concerns that the phrase "little or no realistic alternative to avoid" in the description of a present obligation is open to different interpretations. They proposed removal of the words "little or" from this phrase in order to reduce the potential for misinterpretation. The IPSASB considered this proposal. The IPSASB was concerned that such a change might be interpreted as establishing a threshold test of virtual certainty in determining whether a present obligation exists. The IPSASB considers such a threshold too high. ~~Consequently, the IPSASB confirmed that a present obligation is a legally binding or non-legally binding requirement that an entity has little or no realistic alternative to avoid.~~

BC5.31 Determining when a present obligation arises in a public sector context is complex and, in some cases, might be considered arbitrary. This is particularly so when considering whether liabilities can arise from obligations that are not enforceable by legal or equivalent means. In the context of programs to deliver social benefits there are a number of stages at which a present obligation can arise and there can be significant differences between jurisdictions, even where programs are similar, and also over time within the same jurisdiction—for example, different age cohorts may have different expectations about the likelihood of receiving benefits under a social assistance program. Assessing whether a government cannot ignore such expectations and therefore has little or no realistic alternative to transfer resources may be subjective. This gives rise to concerns that such subjectivity undermines consistency in the reporting of liabilities, and can also impact adversely on understandability. Some therefore take the view that an essential characteristic of a liability should be that it is enforceable at the reporting date by legal or equivalent means.

BC5.32 A converse view is that where a government has a record of honoring obligations, failing to recognize them as liabilities leads to an overstatement of that government's net financial position. According to this view, if a government has a consistent record of raising citizen expectations through publicly-announced obligations to provide financial support—for example to the victims of natural disasters—and has met such obligations in the past, a failure to treat such obligations as liabilities is not in accordance with the objectives of financial reporting, and leads to the provision of information that does not meet the qualitative characteristics of faithful representation and relevance.

BC5.33 On balance, the IPSASB agrees with those who argue that, in the public sector, liabilities can arise from binding obligations that the entity has little or no realistic alternative to avoid, even if they are not enforceable in law. The IPSASB decided to use the term "non-legally binding obligations" for such obligations in the Conceptual Framework. However, the IPSASB acknowledges the views of those who are skeptical that liabilities can arise from obligations that are not legally enforceable. Consequently, paragraph ~~5.23~~ 5.15F of this Chapter identifies the attributes that a non-legally binding obligation is to possess for it to give rise to a liability.

BC5.34 The wide variation in the nature of public sector programs and operations, and the different political and economic circumstances of jurisdictions globally, means that categorical assertions of the circumstances under which obligations not enforceable in law become binding and give rise to present obligations are inappropriate. However, the IPSASB is of the view that present obligations are extremely unlikely to arise from election pledges. This is because electoral pledges will very rarely, (a) create a valid expectation on the part of external parties that the entity will honor the pledge, and (b) create an obligation which the entity has no realistic alternative but to settle. Therefore, the Conceptual Framework includes a presumption that liabilities do not arise from electoral pledges. However, it is accepted that in practice a government with a large majority will be better placed to enact intended legislation than a minority government, and that there may be infrequent circumstances where a government announcement in such circumstances might give rise to a liability. In assessing whether, in these circumstances, a non-legally binding obligation gives rise to a liability the availability of funding to settle the obligation may be an indicator. This is discussed in paragraph ~~5.25~~ 5.17C.

Sovereign Power to Avoid Obligations

BC5.35 The sovereign power to make, amend and repeal legal provisions is a key characteristic of governments. Sovereign power potentially allows governments to repudiate obligations arising from both exchange and non-exchange transactions. Although in a global environment such a power may be constrained by practical considerations, there are a large number of examples of governments defaulting on financial obligations over the last century. The IPSASB considered the impact of sovereign power on the definition of a liability. The IPSASB concluded that failing to recognize obligations that otherwise meet the definition of a liability on the grounds that sovereign power enables a government to walk away from such obligations would be contrary to the objectives of financial reporting and, in particular, may conflict with the qualitative characteristics of relevance and faithful representation. Many respondents to the Consultation Paper and the Exposure Draft supported this position. The IPSASB therefore concluded that the determination of the existence of a liability should be by reference to the legal position at the reporting date.

Commitments

BC5.36 Commitment accounting procedures are a central component of budgetary control for public sector entities in many jurisdictions. They are intended to assure that budgetary funds are available to meet the government's or other public sector entity's responsibility for a possible future liability, including intended or outstanding purchase orders and contracts, or where the conditions for future transfers of funds have not yet been satisfied. Commitments which satisfy the definition of a liability and the recognition criteria are recognized in financial statements, in other cases information about them may be communicated in notes to the financial statements or other reports included in GPFRs. The IPSASB concluded that commitment accounting might be addressed in the future when dealing with elements for the more comprehensive areas of general purpose financial reporting outside the financial statements.

Unit of Account and Accounting Principles for Binding Arrangements that are Equally Unperformed

Unit of Account

BC5.36A The IASB 2018 Conceptual Framework describes unit of account as 'the right or the group of rights, the obligation or the group of obligations, or the group of rights and obligations, to which recognition criteria and management concepts are applied'.

BC5.36B The IPSASB took the view that unit of account was a standards-level issue during the development of the 2014 IPSASB Conceptual Framework and there was no guidance on unit of account. Since 2014 the importance of decisions on the unit of account has been highlighted in a number of projects and led the IPSASB to reevaluate the case for high-level guidance.

BC5.36C The IPSASB decided that guidance in the Conceptual Framework would be beneficial in informing standards-level requirements and guidance on unit of account. The IPSASB drew on the IASB 2018 Framework for this guidance, which is in paragraphs 5.27A-5.27J. The guidance on consideration of how the selection of a unit of account provides useful information in the IASB 2018 Conceptual Framework is in the context of the qualitative characteristics of relevance and faithful representation. The IPSASB took the view that other qualitative characteristics may need to be taken into account in assessing whether information is useful in determining the unit of account.

BC5.36D There was considerable support for the Conceptual Framework providing guidance on the unit of account. The only significant issue to arise was the location of the guidance on accounting for binding arrangements that are equally unperformed (see paragraph BC5.36H). The IPSASB decided that Chapter 5 should address unit of account.

BC5.36E The IPSASB considered whether the unit of account for recognition could differ from the unit of account for measurement. The IPSASB acknowledged that it is possible that items might be recognized on an individual basis and measured on a group basis. An example is where financial instruments might be recognized individually but measured as a portfolio. Where different units of account are applied for recognition and measurement the reason(s) will be explained in the Basis for Conclusions of the individual standards.

Binding Arrangements that are Equally Unperformed

BC5.36F The IPSASB 2014 Conceptual Framework does not include guidance on executory contracts. In the Limited Scope Update, the IPSASB evaluated whether guidance should be added to the Conceptual Framework.

BC5.36G The IASB 2018 Conceptual Framework describes an executory contract as "a contract or a portion of a contract, that is equally unperformed—neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent".

BC5.36H The IPSASB noted that the term "contract" has been problematic in some jurisdictions. This is because some public sector entities may not have powers to enter into contracts, although they may be able to enter into other binding arrangements. Consequently, the term "contract" has not been used widely in the Conceptual Framework. At the standards level the term "binding arrangement" has been generally used. The IPSASB has used this term in the Conceptual Framework. The IPSASB concluded that the principles of accounting for binding arrangements that are equally unperformed could be incorporated in the section on Unit of Account and that a separate section was unnecessary.

BC5.36I Most respondents to ED 81 supported the inclusion of guidance on accounting for binding arrangements that are equally unperformed. However, a number disagreed with the location of this guidance in the section of Unit of Account. They considered that the implications of the guidance extended beyond considerations related to unit of account to include areas such as the definition of an asset and a liability. They encouraged the IPSASB to relocate the guidance to a separate sub-section. The IPSASB accepted the views of these respondents and decided to relocate the guidance to a separate sub-section in paragraphs 5.27I and 5.27J.

Net Financial Position, Other Resources and Other Obligations

BC5.37 This section of the Basis for Conclusions outlines the IPSASB's approach to models of financial performance to be reported in the financial statements, and specifically the treatment of deferred inflows and deferred outflows.

Consultation Paper, Elements and Recognition in Financial Statements

BC5.38 The 2010 Consultation Paper discussed two contrasting approaches to financial performance:

- An approach that measures financial performance as the net result of all changes in the entity's resources and obligations during the period. This was described as the asset and liability-led approach; and

- An approach that measures financial performance as the result of the revenue inflows and expense outflows more closely associated with the operations of the current period. This was described as the revenue and expense-led approach.

BC5.39 The 2010 Consultation Paper noted that the two different approaches could lead to different definitions of the elements related to financial performance and financial position. The revenue and expense-led approach is strongly linked to the notion of inter-period equity. Inter-period equity refers to the extent to which the cost of programs and providing services in the reporting period is borne by current taxpayers and current resource providers. The asset and liability-led approach is linked to the notion of changes in resources available to provide services in the future and claims on these resources as a result of period activity.

BC5.40 A further section of the 2010 Consultation Paper discussed Other Potential Elements and pointed out that, if IPSASB adopted the revenue and expense-led approach, IPSASB would need to address deferred flows. Under this approach, deferred flows are items that do not meet the proposed definitions of revenue and expense, but which are nevertheless considered to affect the financial performance of the period. The Consultation Paper identified three options for dealing with such flows:

- Defining deferred inflows and deferred outflow as elements on the statement of financial position;
- Broadening the asset and liability definitions to include items that are deferrals; or
- Describing deferred flows as sub-classifications of net assets/net liabilities (subsequently referred to as the residual amount).

BC5.41 The 2010 Consultation Paper had two specific matters for comment on these areas. The first asked constituents to indicate whether they preferred the asset and liability-led approach or revenue and expense-led approach and to indicate their reasons. The second asked whether deferred inflows and deferred outflows need to be identified on the statement of financial position. If respondents supported identification on the statement of financial position they were asked to indicate which of the three approaches in paragraph BC5.40 they supported.

BC5.42 The responses to these specific matters for comment were inconclusive. A small majority of respondents expressing a view favored the asset and liability-led approach. However, a number of respondents who supported the asset and liability-led approach also indicated that they favored identifying deferrals on the statement of financial position. The IPSASB took these views into account in the development of the ~~at~~ 2012 Exposure Draft ~~stage~~.

Exposure Draft, Elements and Recognition in Financial Statements

BC5.43 The 2012 Exposure Draft expressed a view that it is important to be able to distinguish flows that relate to the current reporting period from those that relate to specified future reporting periods. The 2012 Exposure Draft therefore proposed the following definitions of a deferred inflow and a deferred outflow:

- *A deferred inflow is an inflow of service potential or economic benefits provided to the entity for use in a specified future reporting period that results from a non-exchange transaction and increases net assets; and*

- *A deferred outflow is an outflow of service potential or economic benefits provided to another entity or party for use in a specified future reporting period that results from a non-exchange transaction and decreases net assets.*

BC5.44 The two key features of these definitions were:

- The proposed elements were restricted to non-exchange transactions; and
- The flows had to be related to a specified future period.

BC5.45 The IPSASB's rationale for including these characteristics were as risk-avoidance measures to reduce the possibility of deferred inflows and deferred outflows being used widely as smoothing devices, and to ensure that deferred inflows and deferred outflows are not presented on the statement of financial position indefinitely. The Exposure Draft included two Alternative Views. The first Alternative View considered the meaning of net financial position to be unclear in light of the combined impact of deferred inflows and deferred outflows. The second Alternative View disagreed with the view that deferred inflows and deferred outflows should be identified and recognized as separate elements and expressed a view that these flows meet the definitions of revenue and expense.

BC5.46 Many respondents disagreed with defining deferred inflows and deferred outflows as elements. Some expressed reservations about the implications for alignment with the ~~International Accounting Standards Board's~~ IASB's Conceptual Framework, and International Financial Reporting Standards more generally. A number of respondents considered that the proposed approach did not reflect economic reality and that it would be more difficult to determine an objective basis for deferring revenue and expense under the revenue and expense-led approach. Nevertheless, a number of respondents also expressed the view that information on flows relating to particular reporting periods has information value.

BC5.47 The rationale for restricting the definitions to non-exchange transactions was challenged as conceptually weak both by respondents who favored defining deferred inflows and deferred outflows as elements and those opposed to these proposed elements. Respondents also disagreed with the restriction to specified time periods, because it would potentially lead to the different accounting treatment of very similar transactions dependent upon whether a specific period was identified—a grant without conditions receivable by an entity to finance its general activities for a five year period would have met the definition of a deferred inflow, whereas a similar grant for a future unspecified period would have met the definition of revenue.

Finalizing the Elements Chapter

BC5.48 The IPSASB considered that it needed to balance the limited support for the proposals on deferred flows in the 2012 Exposure Draft, and the perceived needs of users for information about flows relating to particular reporting periods.

BC5.49 The IPSASB therefore considered five options (A–E below) in responding to input from the due process and its perception of users' information needs:

A. Defining deferred inflows and deferred outflows as elements in a more principles-based manner and not specifying the financial statements in which the elements are to be recognized. As such, the Conceptual Framework would not predetermine the presentation of the elements;

B. Deriving the definitions of revenue and expense from the asset and liability definitions;

C. Broadening the asset and liability definitions;

D. Accepting that certain economic phenomena that do not meet the definition of any element may need to be recognized in financial statements in order to meet the objectives of financial reporting; and

E. Reporting inflows and outflows that provide service potential or economic benefits, but do not affect assets and liabilities as defined in the Conceptual Framework and reporting inflows and outflows that do not affect revenue and expense.

BC5.50 The IPSASB ~~does~~ did not consider that defining deferred inflows and deferred outflows as elements in Option A is justified in light of the objections that respondents had made to the proposals in the 2012 Exposure Draft. The IPSASB therefore rejected Option A.

BC5.51 The IPSASB considered two variants of Option B. In the first variant deferred flows would be taken directly to surplus/deficit, while in the second variant deferred flows would initially be taken to residual amount and then recycled to surplus/deficit in the period that time stipulations occur.

BC5.52 The IPSASB considers that taking deferred flows directly to surplus/deficit under the first variant of Option B may not produce information that is representationally faithful of an entity's sustainable performance and therefore does not meet the objectives of financial reporting. The second variant of Option B relies on recycling and, in the view of some IPSASB members would have implicitly introduced the notion of "other comprehensive income" into the Conceptual Framework. The IPSASB has strong reservations about such a development. For these reasons the IPSASB rejected Option B.

BC5.53 The IPSASB noted that Option C would require changes to the definitions of an asset and a liability so that:

- The definition of an asset would include resources that an entity does not control; and
- The definition of a liability would include obligations that are not present obligations.

The IPSASB considers that such changes would distort the essential characteristic of an asset—that an entity controls rights to resources—and the essential characteristic of a liability—that an entity has a present obligation for an outflow of resources. In the view of the IPSASB this would make assets and liabilities less easily understandable. Adoption of such an option would also be a departure from globally understood definitions of an asset and a liability. For these reasons the IPSASB rejected Option C.

BC5.54 Option E was a hybrid approach that involved components of the other four options. It would allow reporting of inflows and outflows that provide service potential or economic benefits, but would not affect the definitions of an asset and liability and the reporting of inflows and outflows that do not affect revenue and expense as defined in the Conceptual Framework. The idea of this approach was to acknowledge that further conceptual thinking on financial performance is necessary.

BC5.55 Option D is broader than Option E because it is not necessarily restricted to deferred flows, but could encompass broader economic phenomena—for example obligations that are not present obligations, because, although they contain performance obligations, it is not clear that they require ~~an outflow~~ a transfer of resources. Option D acknowledges that there may be circumstances under which the six elements defined in the Conceptual Framework may not provide all the information in the financial statements that is necessary to meet users' needs. In the view of the IPSASB it is transparent to acknowledge that other items may be recognized. Unlike Option A, Option D does not involve defining additional elements, and, unlike Option C, Option D does not involve modification of generally understood definitions of an asset and a liability.

BC5.56 The IPSASB concluded that Option D provides the most transparent approach. The terms "other obligations" and "other resources" are used to describe these economic phenomena in the Conceptual Framework. Option D also enhances the accountability of the IPSASB because the circumstances under which other obligations and other resources will be recognized will be determined at standards level and explained in the Bases for Conclusions of specific standards.

Financial Statements

BC5.57 Net financial position is the aggregate of an entity's net assets (assets minus liabilities) and other resources and other obligations recognized in the statement of financial position at the reporting date. Where resources and obligations other than those that meet the definition of the elements are recognized in the financial statements, the amounts reported as net assets and net financial position will differ. In these circumstances, the interpretation of net financial position will be determined by reference to the nature of the other resources and other obligations recognized in the financial statements under the relevant IPSAS.

BC5.58 The IPSASB considered whether it should use both the terms "net assets" and "net financial position" in the Conceptual Framework. The IPSASB acknowledges a view that net assets is a generally understood term. However, the IPSASB considered that using both terms could be confusing and therefore decided to use the term "net financial position" to indicate the residual amount of an entity.

Revenue and Expense

Gross or Net Increase in "Net Financial Position" in Definition of Revenue

BC5.59 The IPSASB considered whether the definition of revenue should specify that the increase in net financial position is "gross" or "net". The IPSASB acknowledges that a gross approach might not be appropriate in areas such as the disposal of property, plant, and equipment where such an approach would require the full disposal proceeds to be recognized as revenue, rather than the difference between the disposal proceeds and the carrying amount. Conversely, a net approach might be similarly inappropriate in certain circumstances—for example, the sale of inventory. The IPSASB concluded that whether the increase in net financial position represented by revenue is presented gross or net should be determined at standards level, dependent on which treatment better meets the objectives of financial reporting.

Distinguishing Ordinary Activities from Activities outside the Ordinary Course of Operations

BC5.60 Some standard setters structure their definitions of elements so that, for example, inflows and outflows arising from transactions and events relating to activities in the ordinary course of operations are distinguished from inflows and outflows that relate to activities outside the ordinary course of operations. An example of this approach is to define revenue and expense as elements that relate to an entity's "ongoing major or central operations," and to define gains and losses as elements that relate to all other transactions, events and circumstances giving rise to increases or decreases in net assets.[4]

BC5.61 The IPSASB acknowledges that distinguishing transactions and events related to the ordinary course of operations from transactions and events outside the ordinary course of operations can provide useful information for users of the financial statements. Therefore, it may be useful to adopt the terms “gains and losses” to reflect inflows and outflows from transactions and events outside the ordinary course of operations. However, the IPSASB is of the view that, conceptually, gains and losses do not differ from other forms of revenue and expense, because they both involve net increases or decreases of assets and/or liabilities. The IPSASB also noted that many respondents to the 2010 Consultation Paper and 2012 Exposure Draft shared this view. Therefore, the IPSASB decided not to define gains and losses as separate elements.

Ownership Interests in the Public Sector

BC5.62 As discussed in more detail in BC5.66-BC5.68, the IPSASB considered whether, and, if so, under what circumstances, ownership interests exist in the public sector and whether transactions related to ownership interests should be excluded from the definitions of revenue and expense. Because transactions with owners, in their role as owners, are different in substance to other inflows and outflows of resources the IPSASB concluded that it is necessary to distinguish flows relating to owners from revenue and expense. Therefore, ownership contributions and ownership distributions are defined as elements and excluded from the definitions of revenue and expense.

Surplus or Deficit in the Reporting Period

BC5.63 This chapter states that the difference between revenue and expense is the entity’s surplus or deficit for the period. The IPSASB considered whether it should provide explanatory guidance on the interpretation of surplus or deficit. The IPSASB discussed a view that public sector entities have operating and funding models. According to this view a surplus provides an indicator of the ability of the entity to:

- Reduce demands for resources from resource providers;
- Increase either the volume and/or quality of services to recipients;
- Reduce debt (where an entity has debt-raising powers); or
- A combination of these factors.

BC5.64 Conversely a deficit provides an indicator of:

- The need to increase demands on resources from resource providers;
- Reduce either the volume and/or quality of services to recipients;
- Increase debt (where an entity has debt-raising powers); or
- A combination of these factors.

BC5.65 The IPSASB acknowledges that there is a need for greater clarity on the meaning of surplus or deficit in the public sector, and therefore that aspects of the above approach might be developed further in the future. However, the IPSASB considered the concept of an operating and funding

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[4] See, for example, Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements*.

model or business model is not well developed in the public sector, and that developing an operating and funding model appropriate for all public sector entities is problematic. Therefore, the IPSASB decided not to include guidance on the interpretation of surplus or deficit in the Conceptual Framework.

Ownership Contributions, and Ownership Distributions

BC5.66 The IPSASB considered whether net financial position is a residual amount, a residual interest or an ownership interest. The IPSASB acknowledges the view that the interest of resource providers and service recipients in the long-term efficiency of the entity, its capacity to deliver services in the future and in the resources that may be available for redirection, restructuring or alternative disposition is similar to an ownership interest. The IPSASB also accepts that the terms "residual interest" and "ownership interest" have been used in some jurisdictions to characterize third parties' interests in net assets. The term "residual interest" indicates that service recipients and resource providers have an interest in the capability of the entity to finance itself and to resource future operations. The term "ownership interest" is analogous to the ownership interest in a private sector entity and, for some, indicates that the citizens own the resources of the public sector entity and that government is responsible to the citizens for the use of those resources. Some supporters of this approach argue that it emphasizes the democratic accountability of governments.

BC5.67 The IPSASB is of the view that the term "residual interest" may also suggest that service recipients and resource providers have a financial interest in the public sector entity. Similarly, the term "ownership interest" may suggest that citizens are entitled to distributions from the public sector entity and to distributions of resources in the event of the entity being wound up. The IPSASB therefore concluded that the terms "residual interest" and "ownership interest" can be misunderstood or misinterpreted, and that net financial position is a residual amount that should not be defined.

BC5.68 However, the IPSASB acknowledges that part of net financial position can in certain circumstances be an ownership interest. Such instances may be evidenced by the entity having a formal equity structure. However, there may be instances where an entity is established without a formal equity structure, with a view to sale for operation as a commercial enterprise or by a private sector not-for-profit entity. An ownership interest can also arise from the restructuring of government or public sector entities, such as when a new government department is created. The IPSASB therefore considered whether ownership interests should be defined as an element. The IPSASB acknowledges the view that identifying the resources (or claims on future resources) attributable to owners provides information useful for accountability and decision-making purposes. The IPSASB concluded that such interests can be identified through the sub-classification of net financial position. However, the IPSASB also concluded that it is important to distinguish inflows of resources from owners and outflows of resources to owners, in their role as owners, from revenue, expense, other resources and other obligations. Therefore, ownership contributions and ownership distributions are defined as elements. Detailed guidance to support the assessment of whether certain inflows and outflows of resources satisfy the definitions of ownership contributions and ownership distributions will be developed at standards level, as appropriate.

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Agenda Item 5.1

Memorandum

Date:	30 November 2023
To:	NZASB Members
From:	Alex Stainer
Subject:	**Approval of RDR Concessions for Lack of Exchangeability**

COVER SHEET

Project priority and complexity

Project priority	**Low** This is a narrow scope amending standard which is likely to have limited applicability.
Complexity of Board decision-making at this meeting	**Low** The Board is being asked to approve for issue an amending standard modifying the disclosure requirements introduced by *Lack of Exchangeability* for Tier 2 for-profit entities. No comments on the proposed amendments were received.

Overview of agenda item

Project status	Approval – we are seeking approval to issue RDR concessions for *Lack of Exchangeability.*
Project purpose	To introduce RDR concessions for relevant disclosures in the recently issued *Lack of Exchangeability* amending standard for Tier 2 reporting entities.
Board action required at this meeting	APPROVAL to issue RDR concessions for *Lack of Exchangeability*.

Recommendations

1. We recommend that the Board:

   (a) APPROVES for issue the Tier 2 for-profit amending standard *Lack of Exchangeability RDR*; and

   (b) APPROVES the signing memorandum from the Chair of the NZASB to the Chair of the XRB Board requesting approval to issue *Lack of Exchangeability RDR*.

Background

2. At the Board meeting held on 19 October, the Board approved the amending standard *Lack of Exchangeability*, which introduced new requirements, guidance and disclosures relating to estimating the spot exchange rate when a currency is not exchangeable into another currency.

3. At the same meeting, the Board agreed to consult on proposed Tier 2 disclosure concessions in NZ IAS 21 *The Effect of Changes in Foreign Exchange Rates,* for some of the disclosures introduced by *Lack of Exchangeability.* The proposed RDR concessions were developed taking into account cost/benefit considerations and consistency with existing RDR concessions provided for similar disclosure requirements.

4. The consultation on the proposed RDR concessions closed on 21 November 2023 and no comments were received.

Due process

5. Section 22 of the Financial Reporting Act 2013 outlines the requirements for consultation prior to the issuance of a standard, an authoritative notice, an amendment, or a revocation by the Board. It specifies that the Board must:

   - take reasonable steps to consult with individuals or representatives who would be substantially affected by the issuance; and

   - consult with the Privacy Commissioner before issuing a standard, an authoritative notice, or an amendment that could potentially require the disclosure of personal information.

6. The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in our view, meets the requirements of section 22(1) of the Financial Reporting Act 2013.

7. In accordance with section 22(2) of the Financial Reporting Act 2013 we have considered whether the amending standard is likely to require the disclosure of personal information. In our view the amending standard does not include requirements that would result in the disclosure of personal information, and therefore no consultation with the Privacy Commissioner is required.

RDR concessions and signing memorandum

8. Attached is the draft amending standard *Lack of Exchangeability RDR*.

9. Attached is a draft signing memorandum from the Chair of the NZASB to the Chair of the XRB Board.

Commencement and Application

10. *Lack of Exchangeability* including RDR concessions will be applicable for annual reporting periods beginning on or after 1 January 2025, with earlier application permitted for accounting periods that begin before this date, but which do not end before it takes effect. This is consistent with the effective date in *Lack of Exchangeability* to the extent permitted under section 28 of the Financial Reporting Act 2013.

Questions for the Board

Q1. Does the Board APPROVE for issue *Lack of Exchangeability RDR* which amends NZ IAS 21?

Q2. Does the Board APPROVE the signing memorandum from the Chair of the NZASB to the Chair of the XRB Board, requesting approval to issue the amending standard *Lack of Exchangeability RDR*?

Attachments

Agenda item 5.2: Draft *Lack of Exchangeability RDR*

Agenda item 5.3: Draft signing memorandum

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Lack of Exchangeability RDR

Mandatory 1 January 2025

Issued January 2024

Lack of Exchangeability RDR

Issued January 2024

This Tier 2 for-profit amending Standard introduces disclosure concessions in response to new disclosures established by *Lack of Exchangeability*, issued 2 November 2023. This amending Standard modifies the disclosure requirements in NZ IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

In finalising this Standard, the New Zealand Accounting Standards Board has carried out appropriate consultation in accordance with section 22(1) of the Financial Reporting Act 2013.

Legal status of amending Standard

This amending Standard was issued on 18 January 2024 by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013.

This amending Standard is secondary legislation for the purposes of the Legislation Act 2019.

The amending Standard, pursuant to section 27(1) of the Financial Reporting Act 2013, takes effect on the 28th day after the date of its publication. The amending Standard was published under the Legislation Act 2019 on 18 January 2024 and takes effect on 15 February 2024.

Commencement and application

The amending Standard has a mandatory date of 1 January 2025, meaning it must be applied by Tier 2 for-profit entities for accounting periods that begin on or after this date.

Application to an earlier accounting period is permitted for accounting periods that end after this amending Standard takes effect – refer to paragraph NZ 60N.4 – NZ 60N.7 of this amending Standard.

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Part A – Introduction

This amending Standard amends the disclosure requirements in NZ IAS 21 *The Effects of Changes in Foreign Exchange Rates* introduced by *Lack of Exchangeability* issued 2 November 2023 for Tier 2 for-profit entities.

Part B – Scope

This Standard applies to Tier 2 for-profit entities. A Tier 2 entity is not required to comply with the disclosure requirements in this Standard denoted with an asterisk (*).

Part C – Amendments to NZ IAS 21 *The Effects of Changes in Foreign Exchange Rates*

Paragraphs 57A, A19 and A20 are amended (by denoting disclosure concessions for Tier 2 entities with asterisks). Paragraphs NZ60N.4–NZ60N.7 are added. Paragraph A18 is not amended but is included for context. New text is underlined.

Disclosure

...

57A When an entity estimates a spot exchange rate because a currency is not exchangeable into another currency (see paragraph 19A), the entity shall disclose information that enables users of its financial statements to understand how the currency not being exchangeable into the other currency affects, or is expected to affect, the entity's financial performance, financial position and cash flows. To achieve this objective, an entity shall disclose information about:

(a) the nature and financial effects of the currency not being exchangeable into the other currency;

(b) the spot exchange rate(s) used;

<u>*</u>(c) the estimation process; and

<u>*</u>(d) the risks to which the entity is exposed because of the currency not being exchangeable into the other currency.

57B Paragraphs A18–A20 specify how an entity applies paragraph 57A.

Commencement and application

...

<u>Lack of Exchangeability RDR</u>

NZ60N.4 <u>*Lack of Exchangeability RDR*, issued in January 2024, amended disclosure requirements in paragraph 57A and in Appendix A paragraphs A19 and A20. An entity shall apply those amendments in accordance with the commencement and application date provisions in paragraphs NZ 60N.5 - NZ 60N.7. An entity that applies the amendments to an 'early adoption accounting period' shall disclose that fact.</u>

<u>When amending Standard takes effect (section 27 Financial Reporting Act 2013)</u>

NZ60N.5 <u>The amending Standard takes effect on the 28th day after the date of its publication under the Legislation Act 2019. The amending Standard was published on 18 January 2024 and takes effect on 15 February 2024.</u>

Accounting period in relation to which standards commence to apply (section 28 Financial Reporting Act)

NZ60N.6 The accounting periods in relation to which this amending Standard commences to apply are:

(a) for an **early adopter**, those accounting periods following and including, the **early adoption accounting period**.

(b) for any other reporting entity, those accounting periods following, and including, the first accounting period for the entity that begins on or after the **mandatory date.**

NZ60N.7 In paragraph NZ 60N.6:

early adopter means a reporting entity that applies this amending Standard for an early adoption accounting period

early adoption accounting period means an accounting period of the early adopter:

(a) that begins before the mandatory date but has not ended or does not end before this amending Standard takes effect (and to avoid doubt, that period may have begun before this amending Standard takes effect); and

(b) for which the early adopter:

(i) first applies this amending Standard in preparing its financial statements; and

(ii) discloses in its financial statements for that accounting period that this amending Standard has been applied for that period.

mandatory date means 1 January 2025.

...

Appendix A
Application guidance

This appendix is an integral part of the Standard.

Exchangeability

[…]

Disclosure when a currency is not exchangeable

A18 An entity shall consider how much detail is necessary to satisfy the disclosure objective in paragraph 57A. An entity shall disclose the information specified in paragraphs A19–A20 and any additional information necessary to meet the disclosure objective in paragraph 57A.

A19 In applying paragraph 57A, an entity shall disclose:

(a) the currency and a description of the restrictions that result in that currency not being exchangeable into the other currency;

(b) a description of affected transactions;

(c) the carrying amount of affected assets and liabilities;

(d) the spot exchange rates used and whether those rates are:

(i) observable exchange rates without adjustment (see paragraphs A12–A16); or

(ii) spot exchange rates estimated using another estimation technique (see paragraph A17);

*(e) a description of any estimation technique the entity has used, and qualitative and quantitative information about the inputs and assumptions used in that estimation technique; and

*(f) qualitative information about each type of risk to which the entity is exposed because the currency is not exchangeable into the other currency, and the nature and carrying amount of assets and liabilities exposed to each type of risk.

A20 When a foreign operation's functional currency is not exchangeable into the presentation currency or, if applicable, the presentation currency is not exchangeable into a foreign operation's functional currency, an entity shall also disclose:

(a) the name of the foreign operation; whether the foreign operation is a subsidiary, joint operation, joint venture, associate or branch; and its principal place of business;

(b) summarised financial information about the foreign operation; and

*(c) the nature and terms of any contractual arrangements that could require the entity to provide financial support to the foreign operation, including events or circumstances that could expose the entity to a loss.

Agenda Item 5.3

XRB | Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Memorandum

Date:	12 December 2023
To:	Michele Embling, Chair External Reporting Board
From:	Carolyn Cordery, Chair NZASB
Subject:	***RDR Concessions for Lack of Exchangeability***

Introduction[1]

1. In accordance with the protocols established by the XRB Board, NZASB seeks your approval to issue *Lack of Exchangeability RDR* which amends NZ IAS 21 *The Effect of Changes in Foreign Exchange Rates*.

2. The objective of issuing *Lack of Exchangeability RDR* is to introduce Tier 2 disclosure concessions for several of the disclosures established by *Lack of Exchangeability*, previously issued by the NZASB in November 2023.

Due process

3. The NZASB issued the RDR concessions in *Lack of Exchangeability RDR* for consultation in November 2023. Comments were due to the NZASB on 21 November 2023. No comments were received.

4. The NZASB has approved *Lack of Exchangeability RDR.* The due process followed by the NZASB complied with the due process requirements established by the XRB Board and, in the NZASB's view, meets the requirements of section 22 of the Financial Reporting Act 2013.

5. In accordance with section 22(2) of the Financial Reporting Act 2013 the NZASB has considered whether the amending standard is likely to require the disclosure of personal information. In the NZASB's view the amending standard does not include requirements that would result in the disclosure of personal information and therefore no consultation with the Privacy Commissioner is required.

Consistency with XRB Financial Reporting Strategy

6. The NZASB proposed concessions for several disclosures introduced by *Lack of Exchangeability* for the following reasons.

   a. It is not clear that there is sufficient benefit to users of Tier 2 entities' financial statements to justify the additional costs of the disclosures.

   b. These disclosures are similar to other disclosures relating to estimation and risks that are subject to RDR concessions within the suite of standards. Therefore, we consider it is consistent and logical to extend the same concessions to the disclosures of this type introduced by *Lack of Exchangeability*.

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

7. The IASB expects to issue a reduced disclosure standard, *Subsidiaries without Public Accountability: Disclosures,* in 2024. In developing this standard, the IASB considered disclosure requirements in IFRS Accounting Standards issued up until 28 February 2021. For disclosures introduced after February 2021, the IASB decided to review and consider these in the context of the new standard, only after it has been issued. Therefore, the IASB is expected to consider whether to propose amendments to the new standard for the disclosures introduced by *Lack of Exchangeability* in the near future.

8. The issue of this amending standard is consistent with elements of the Financial Reporting Strategy that are relevant to a domestic standard that introduces RDR concessions for Tier 2 for-profit entities: it retains a harmonised position with Australia for Tier 1 for-profit entities and is consistent with the Accounting Standards Framework.

Commencement and application date

9. The commencement and application date requirements for the amending standard is included in Appendix A of this memo. An entity that is not an early adopter is required to apply the amending standard for accounting periods beginning on or after 1 January 2025. Application is permitted for an 'early adoption accounting period' when that period begins before the mandatory date but has not ended or does not end before this amending standard takes effect (as defined in Appendix A).

Other matters

10. There are no other matters relating to the issue of this *Lack of Exchangeability RDR* that the NZASB considers to be pertinent or that should be drawn to your attention.

Recommendation

11. The NZASB recommends that you sign the attached certificate of determination on behalf of the XRB Board.

Attachments

Lack of Exchangeability RDR

Certificate of determination

Carolyn Cordery
Chair NZASB

Appendix A: Commencement and application

A1. The commencement and application provisions below will apply to the amending standard once it is published.

When standard takes effect (section 27 Financial Reporting Act 2013)

A2. This standard takes effect on the 28th day after the date of its publication under the Legislation Act 2019. The standard is expected to be published on 18 January 2024 and take effect on 15 February 2024.

Accounting periods in relation to which standards commence to apply (section 28 Financial Reporting Act 2013)

A3. The accounting periods in relation to which this standard commences to apply are:

(a) for an early adopter, those accounting periods following, and including, the early adoption accounting period; and

(b) for any other reporting entity, those accounting periods following, and including, the first accounting period for the entity that begins on or after the mandatory date.

A4. In applying paragraph A3:

early adopter means a reporting entity that applies the standard for an early adoption accounting period.

early adoption accounting period means an accounting period of the early adopter:

(a) that begins before the mandatory date but has not ended or does not end before this standard takes effect (and to avoid doubt, that period may have begun before this standard takes effect); and

(b) for which the early adopter:

(i) first applies this standard in preparing its financial statements; and

(ii) discloses in its financial statements for that accounting period that the standard has been applied for that period.

mandatory date means 1 January 2025.

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

Memorandum

Date:	1 December 2023
To:	NZASB Members
From:	Carly Berry
Subject:	**Application of the PBE Policy Approach to IPSAS 49 *Retirement Benefit Plans***

COVER SHEET

Project priority and complexity

Project priority	**Low** Due to the fact that public sector retirement benefit plans in New Zealand are typically classified as for-profit entities, IPSAS 49 *Retirement Benefit Plans* is expected to have minimal importance and relevance to New Zealand constituents.
Complexity of Board decision-making at this meeting	**Medium** The Board is required to apply the PBE Policy Approach to IPSAS 49. There is a degree of judgement involved in the application of the PBE Policy Approach – and reaching a view on whether to commence a PBE project based on the recently issued IPSAS.

Overview of agenda item

Project status	Application of the PBE Policy Approach.
Project purpose	N/A – there is currently no project relating to this new IPSAS.
Board action required at this meeting	• NOTE the recent publication of IPSAS 49. • APPLY the PBE Policy Approach to IPSAS 49. • AGREE NOT to commence a project to develop a PBE Standard, using IPSAS 49 as a starting point.

Introduction[1]

1. IPSAS 49 *Retirement Benefit Plans* was issued by the International Public Sector Accounting Standards Board (IPSASB) on 7 November 2023. IPSAS 49 provides a principles-based approach to accounting by retirement benefit plans to provide a complete view of their financial activities, assets and obligations.

2. IPSAS 49 was adapted from IAS 26 *Accounting and Reporting by Retirement Benefit Plans* to provide public sector-relevant information to users of the financial statements of retirement benefit plans.

3. In accordance with the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach), the Board is required to consider if and when to incorporate IPSAS 49 into the suite of PBE Standards. The content of this memo therefore discusses the application of the PBE Policy Approach to IPSAS 49.

Recommendation

4. We recommend that the Board:

   (a) NOTES that the IPSASB recently issued IPSAS 49 *Retirement Benefit Plans*;

   (b) APPLIES the PBE Policy Approach and AGREES NOT to commence a project to develop a PBE Standard, using IPSAS 49 as a starting point.

Application of the PBE Policy Approach

5. Shortly after its publication, the Board will typically consider whether a new or amending IPSAS should be adopted into PBE Standards. These decisions are guided by the PBE Policy Approach.

6. The PBE Policy Approach identifies triggers for changes to PBE Standards. One of these triggers is the IPSASB issuing a new IPSAS. Section 4.1 (paragraphs 22–24) of the PBE Policy Approach establishes a rebuttable presumption that the Board will adopt a new or amended IPSAS.

7. The PBE Policy Approach states that it is expected that the adoption of a new or amended IPSAS will lead to higher quality financial reporting by public benefit entities (PBEs) in New Zealand and the factors in the development principle are presumed to be met.

Rebutting the presumption and not adopting a new or amended IPSAS

8. Section 4.1 (paragraphs 25–26) of the PBE Policy Approach discusses the rebuttal of the presumption noted in paragraph 6 of this memo. The PBE Policy Approach states that a decision to rebut this presumption is expected to occur only in exceptional circumstances – examples of such circumstances include where the Board has significant concerns that, in the New Zealand context:

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[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

(a) adoption of a new or amended IPSAS would not be either appropriate or relevant (based on the development principle); and

(b) the costs of adoption of a new or amended IPSAS would outweigh the benefits to users of PBE financial reports.

9. **Table 1** considers the factors in the development principle, as provided for in the PBE Policy Approach, as they apply to IPSAS 49.

Table 1: Factors in the Development Principle

Factors in the Development Principle	Comment
Whether the potential development will lead to higher quality financial reporting by public sector PBEs and not-for-profit entities, including public sector PBE groups and not-for-profit groups, than would be the case if the development was not made.	XRB A1 *Application of the Accounting Standards Framework* defines PBEs as *"reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders."* Due to the nature of retirement benefit plans, our view is that it is unlikely that such an entity has designated, or would be able to designate, itself as a PBE for financial reporting purposes (even when the retirement benefit plan was established by a PBE). This view is supported by the research and targeted outreach we have performed over the last two years, as follows: • There is currently no PBE Standard which covers the accounting and reporting requirements for retirement benefit plans, and we are not aware of concerns about the lack of a PBE Standard on this topic. Therefore, this suggests that there are no entities in New Zealand that require such a standard. • From high-level research done on the Disclose Register and National Provident Fund website in August 2021, we did not identify any retirement benefit plans in New Zealand that are also PBEs. To update our findings, in November 2023 we searched the Disclose Register and National Provident Fund website in order to identify any new retirement benefit plans registered since August 2021 – none were identified. • In September 2021, we asked TRG members whether they are aware of any retirement benefit plans in New Zealand that designate themselves as PBEs. No such plans were identified. • We listed IPSASB ED 82 *Retirement Benefit Plans* as an open consultation on the XRB website when it was issued in April 2022. We did not receive any feedback on this ED. There were also no New Zealand submissions to the IPSASB on this ED[2].

[2] The Board agreed with staff's recommendation not to comment on ED 82 at the Board's April 2022 meeting.

Factors in the Development Principle	Comment
	• To supplement our targeted outreach to the TRG, we also reached out to Treasury and Audit NZ staff during ED 82's consultation period to see if they were aware of any PBE retirement benefit plans. No such plans were identified through this outreach. Based on the above considerations, our view is that IPSAS 49 is not relevant in the New Zealand context, as NZ retirement benefit plans typically designate themselves as for-profit entities and therefore apply the requirements of NZ IAS 26 *Accounting and Reporting by Retirement Benefit Plans*. Therefore, developing a PBE Standard using IPSAS 49 as the starting point would not lead to higher quality financial reporting by PBEs.
Whether the benefits of a potential development will outweigh the costs, considering as a minimum: **(i) *relevance to the PBE sector as a whole:* for example, where the potential development arises from the issue of a new or amended IFRS, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;** **(ii) *relevance to the not-for-profit or public sector sub-sectors:* whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;** **(iii) *coherence:* the impact on the entire suite of PBE Standards (e.g., can the change be adopted without destroying the coherence of the suite);** **(iv) *the impact on mixed groups*.**	Relevance to the PBE sector has been considered above. Due to the standalone nature of IPSAS 49, the overall coherence of the suite of PBE Standards would be unaffected by the decision on whether or not to incorporate the requirements of this IPSAS into the suite. There is no impact on mixed groups. Based on these considerations, there would be a net cost to the development of a PBE Standard using IPSAS 49 as a starting point.
In the case of a potential development arising from the issue of a new or amended IFRS, the IPSASB's likely response to the change (e.g., whether the IPSASB is expected to develop an IPSAS on the topic in an acceptable time frame).	Not applicable.

10. Based on the analysis in Table 1, our view is that the presumption that the Board will adopt IPSAS 49 can be rebutted, as this analysis indicates that IPSAS 49 is not relevant in the New Zealand context. Therefore, our recommendation is that the Board agrees not to commence a project to develop a PBE Standard, using IPSAS 49 as a starting point.

Question for the Board

Q1. Does the Board AGREE NOT to commence a project to develop a PBE Standard, using IPSAS 49 as the starting point?

Next steps

11. Paragraph 26 of the PBE Policy Approach states that, in the event that the presumption to adopt a new or amended IPSAS is rebutted, the Board is required to report to the XRB Board:

    (a) its decision and rationale for the decision, including reference to the relevant factors of the development principle; and

    (b) what, if any, action(s) it plans to take in relation to the new or amended IPSAS (e.g., whether a domestic standard will be developed and whether parts of the new or amended IPSAS will be incorporated into that domestic standard.

12. If the Board agrees with our recommendation in paragraph 10 of this memo, we will draft a paper for the next available XRB Board meeting, setting out our analysis in Table 1. We will also note in the XRB Board paper that there are no plans to take any action with respect to a domestic standard – for-profit entities are required to apply NZ IFRS (which includes NZ IAS 26) and we have not received any stakeholder requests or feedback to suggest that NZ IAS 26 is not working well.

Attachments

Agenda item 7.2: IPSAS 49 *Retirement Benefit Plans*

Final Pronouncement
November 2023

IPSAS®

International Public Sector Accounting Standard ®

IPSAS 49, *Retirement Benefit Plans*

IPSASB International Public Sector Accounting Standards Board®

This document was developed and approved by the International Public Sector Accounting Standards Board® (IPSASB®).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective, the IPSASB sets IPSAS™ and Recommended Practice Guidelines (RPGs) for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSAS relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSAS RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

The structures and processes that support the operations of the IPSASB are facilitated by the International Federation of Accountants® (IFAC®).

IPSAS® 49, RETIREMENT BENEFIT PLANS

CONTENTS

Objective

1. The objective of this Standard is to prescribe the accounting and reporting requirements for public sector retirement benefit plans, which provide retirement benefits to public sector employees and other eligible participants.

Scope

2. A retirement benefit plan that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard.

3. Retirement benefit plans are sometimes referred to by various other names, such as ‘pension schemes’, ‘superannuation schemes’ or ‘retirement benefit schemes’. This Standard regards a retirement benefit plan as a reporting entity separate from the employers of the participants in the plan. All other Standards only apply to the financial statements to the extent that they are not superseded by the requirements in this Standard.

4. This Standard deals with accounting and reporting requirements for the plan for all participants as a group. It does not deal with reports to individual participants about their retirement benefit rights.

5. This Standard deals with retirement benefits for public sector employees and other participants who are eligible to join the plan. It does not deal with other forms of employment benefits, such as employment termination payments, deferred compensation arrangements, long-service leave benefits, special early retirement or redundancy plans, health and welfare plans or bonus plans. Government social security arrangements are also excluded from the scope of this Standard.

6. Retirement benefit plans are normally described as either defined benefit plans or defined contribution plans, each having their own distinctive characteristics. Occasionally plans exist that contain characteristics of both. For the purposes of this Standard, defined benefit plans include hybrid plans, which are retirement benefit plans that contain characteristics of both defined benefit plans and defined contribution plans. References in this Standard to defined benefit plans shall be read as encompassing hybrid plans.

7. Many retirement benefit plans require the creation of separate funds, which may or may not have separate legal identity and may or may not have trustees, to which contributions are made and from which retirement benefits are paid. This Standard applies regardless of whether such a fund is created and regardless of whether there are trustees.

8. Retirement benefit plans with assets invested with insurance companies are subject to the same accounting and funding requirements as privately invested arrangements. Accordingly, they are within the scope of this Standard unless the contract with the insurance company is in the name of a specified participant or a group of participants and the retirement benefit obligation is solely the responsibility of the insurance company.

Definitions

9. The following terms are used in this Standard with the meanings specified:

<u>Actuarial present value of promised retirement benefits</u> is the present value of the expected payments by a retirement benefit plan to participants attributable to service, as employees, already rendered.

Defined benefit plans are, for the purposes of this Standard, retirement benefit plans other than defined contribution plans.

Defined contribution obligations are the amounts owed to participants under the terms of a defined contribution plan.

Defined contribution plans are, for the purposes of this Standard, retirement benefit plans under which amounts to be paid as retirement benefits are determined by contributions to a fund together with investment earnings thereon.

Funding is the transfer of assets to an entity (the retirement benefit plan) separate from the employer/sponsor to meet future obligations for the payment of retirement benefits.

Net assets available for benefits are:

(a) For defined benefit plans – the assets of a plan less liabilities other than the actuarial present value of promised retirement benefits and, in a hybrid plan, the defined contribution obligation to participants; and

(b) For defined contribution plans – the assets of a plan less liabilities other than the defined contribution obligations to participants.

Participants are the members of a retirement benefit plan and others who are entitled to benefits under the plan.

Retirement benefit obligations are:

(a) For defined benefit plans – the actuarial present value of promised retirement benefits; and

(b) For defined contribution plans – the defined contribution obligations.

Retirement benefit plans are arrangements whereby an employer/sponsor provides benefits for participants on or after termination of service as employee (either in the form of an annual income and/or as a lump sum) when such benefits, or the contributions towards them, can be determined or estimated in advance of retirement from the provisions of a document or from the employer's/sponsor's practices.

Vested benefits are benefits, the rights to which, under the conditions of a retirement benefit plan, are not conditional on continued employment.

Any other terms defined in other IPSAS are used in this Standard with the same meaning as in those Standards and are reproduced in the Glossary of Defined Terms published separately.

Recognition

10. For defined benefit plans, retirement benefit obligations owed to participants shall be recognized in the statement of financial position as a provision for the actuarial present value of the promised retirement benefits.

11. For defined contribution plans, retirement benefit obligations owed to participants shall be recognized in the statement of financial position as defined contribution obligations.

Measurement

Valuation of Plan Investments

12. Retirement benefit plan investments shall be measured at fair value.

Actuarial Present Value of Promised Retirement Benefits

13. The actuarial present value of promised retirement benefits for defined benefit plans shall be based on the benefits promised under the terms of the plan on service rendered to date using projected salary levels.

14. If an actuarial valuation has not been prepared at the date of the financial statements, the most recent actuarial valuation, updated for any material transactions and material changes in circumstances shall be used.

Presentation and Disclosure

Presentation of Financial Statements

15. A retirement benefit plan, whether defined benefit or defined contribution, shall present the following:

(a) A statement of financial position;

(b) A statement of changes in net assets available for benefits;

(c) A cash flow statement; and

(d) Notes to the financial statements.

16. A retirement benefit plan shall also explain the changes in retirement benefit obligations to participants either by:

(a) Presenting a statement of changes in retirement benefit obligations; or

(b) Disclosing in the notes to the financial statements a reconciliation between the opening and closing retirement benefit obligation balances.

Financial Statement Content

Statement of Financial Position

17. The face of the statement of financial position shall include line items that present the following amounts (if applicable and as appropriate, but not limited to):

(a) Plan investments (suitably classified);

(b) Contributions receivable;

(c) Other assets;

(d) Benefits due and payable;

(e) Any other liabilities excluding retirement benefit obligations to participants;

(f) Net assets available for benefits;

(g) Provision for actuarial present value of promised retirement benefits in a defined benefit plan;

(h) Defined contribution obligation to participants; and

(i) Excess or deficit.

Statement of Changes in Net Assets Available for Benefits

18. The statement of changes in net assets available for benefits shall present opening and closing balances and include line items that present the following amounts, (if applicable and as appropriate, but not limited to):

(a) Employer/sponsor contributions;

(b) Participant contributions;

(c) Investment income;

(d) Other income;

(e) Benefits paid or payable (analyzed, for example, as retirement, death and disability benefits, or lump sum payments);

(f) Transfers from and to other plans;

(g) Administrative expenses;

(h) Other expenses; and

(i) Taxes on income.

Cash Flow Statement

19. A retirement benefit plan shall prepare a cash flow statement, using the direct method, in accordance with IPSAS 2, *Cash Flow Statements.*

Changes in Retirement Benefit Obligations

20. Paragraph 16 requires a retirement benefit plan to present information that explains the changes in retirement benefit obligations to participants either as a financial statement or as a reconciliation in the notes to the financial statements.

21. This statement or note shall present opening and closing balances and the following information (if applicable and as appropriate, but not limited to):

(a) Amendments to the plan (e.g., changes in participant benefits);

(b) Changes in the nature of the plan (e.g., a merger with another plan);

(c) Participant benefits allocated to defined contribution participant accounts;

(d) Net changes to defined benefit participant accrued benefits (e.g., actuarial movements);

(e) Employer/sponsor contributions;

(f) Participant contributions;

(g) Taxes on contributions;

(i) Benefits paid; and

(j) Administration expenses.

Disclosure

22. The notes to the financial statements of a retirement benefit plan, whether defined benefit or defined contribution, shall disclose the following:

    (a) A summary of significant accounting policies;

    (b) A description of the plan (see paragraph 24) and the effect of any changes in the plan during the period;

    (c) The basis for the valuation of all plan assets, including fair value measurement disclosure per class of plan assets as required by the applicable IPSAS;

    (d) Details of any single investment exceeding either 5 percent of the net assets available for benefits or 5 percent of any class or type of security;

    (e) Details of any investment in the employer/sponsor;

    (f) Liabilities other than the provision for actuarial present value of promised retirement benefits or the defined contribution obligation to participants; and

    (g) A description of the funding policy, including any obligations by the employer/sponsor to meet any actuarial determined shortfall in assets in a funded retirement benefit plan.

23. For defined benefit plans the following shall also be disclosed in the notes to the financial statements:

    (a) The actuarial present value of promised retirement benefits, distinguishing between vested benefits and non-vested benefits;

    (b) A description of the:

        (i) Significant actuarial assumptions made; and

        (ii) Method used to calculate the actuarial present value of promised retirement benefits;

    (c) The effect of any changes in actuarial assumptions that have had a significant effect on the actuarial present value of promised retirement benefits; and

    (d) The date of the actuarial valuation and when the next valuation will be undertaken.

24. A retirement benefit plan's financial statements shall contain a description of the plan. It shall contain the following:

    (a) The name(s) of the employer(s)/sponsor(s) and the participant groups covered;

    (b) The number of participants receiving benefits and the number of other participants, classified as appropriate;

    (c) The type of plan – defined contribution or defined benefit;

    (d) A note as to whether participants contribute to the plan;

    (e) A description of the retirement benefits promised to participants;

    (f) A description of any plan termination terms; and

    (g) Changes in items (a) to (f) during the period covered by the financial statements.

Effective Date and Transition

Effective Date

25. A retirement benefit plan shall apply this Standard for annual financial statements beginning on or after January 1, 2026. Earlier application is permitted. If a retirement benefit plan applies this Standard for a period beginning before January 1, 2026, it shall disclose that fact.

26. When a retirement benefit plan adopts the accrual basis IPSAS of accounting as defined in IPSAS 33, *First*-time *Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent to this effective date, this Standard applies to the retirement benefit plan's financial statements covering periods beginning on or after the date of adoption of IPSAS.

Transition

27. This Standard shall be applied prospectively as of the beginning of the annual period in which it is initially applied.

Appendix A

Application Guidance

This appendix is an integral part of IPSAS 49.

Objective (see paragraph 1)

AG1. The objective of this Standard is to prescribe the accounting and reporting requirements for public sector retirement benefit plans which provide retirement benefits primarily to public sector employees. Some public sector retirement benefit plans may also be open to participants working in the same field in the private sector (e.g., teachers in private sector schools) and are in the scope of this Standard. The aim is to improve the transparency and accountability of public sector retirement benefit plans, by providing information that is useful to users about a public sector retirement benefit plan's obligation in respect of participants' promised retirement benefits.

AG2. This Standard applies to retirement benefit plans established by public sector employers/sponsors to provide retirement benefits (either in the form of an annual income and/or lump sum) primarily to former employees. It does not apply to old-age pensions provided through welfare or social security programs, nor to social security schemes that provide pensions to all citizens.

AG3. The objective of reporting by a defined benefit plan is to provide information about the financial resources and activities of the plan that is useful in assessing the relationship between the accumulation of resources (where the defined benefit plan is funded) and plan benefits over time and, in particular, the extent of any deficits. This objective is usually achieved by providing financial statements that include the following:

(a) The recognition of the actuarial present value of promised retirement benefits (and for hybrid plans, the defined contribution obligation);

(b) Actuarial information about the retirement benefit obligations, including the measurement basis;

(c) A description of significant activities for the period and the effect of any changes relating to the plan, and its membership and terms and conditions;

(d) Statements reporting on the transactions and investment performance for the period and the financial position of the plan at the end of the period;

(e) A description of the investment policies; and

(f) How a pay-as-you-go[1] retirement benefit plan obligation is funded.

AG4. The objective of reporting by a defined contribution plan is to provide information about the plan and the performance of its investments. That objective is usually achieved by providing financial statements that include the following:

(a) The recognition of the defined contribution obligation;

[1] Many public pension systems operate on a pay-as-you-go basis. This means that pensions paid to current pensioners are typically financed from general taxation and from contributions paid by current participants or sponsors during the same period in which pensions are paid.

(b) A description of significant activities for the period and the effect of any changes relating to the plan, and its membership and terms and conditions;

(c) Statements reporting on the transactions and investment performance for the period and the financial position of the plan at the end of the period; and

(d) A description of the investment policies.

AG5. Given the prevalence and significance of retirement benefit scheme obligations primarily to current and former employees, to achieve the objective of improved transparency and accountability, this Standard requires retirement benefit plans to present, on the face of the statement of financial position as obligations, the estimated present value of promised retirement benefits based on the type of plan, with defined benefit plan obligations and defined contribution plan obligations presented differently.

Scope (see paragraphs 2–8)

AG6. A retirement benefit plan is a reporting entity. That is, it reports separately from the employer of the participants in the plan and separately from the entity that administers the plan (which may be the employer or an outsourced service provider). For example, where an entity administers more than one separate retirement benefit plan, this Standard applies to each of those plans and requires financial statements to be prepared for each retirement benefit plan.

AG7. Retirement benefit plans can also be classified as single employer, multi-employer[2], or state plans[3]. That classification may have an impact on the application of IPSAS 39, *Employee Benefits*, but does not alter the application of this Standard.

AG8. Many public sector entities provide retirement benefits for their employees by way of a multi-employer plan or state plan. Multi-employer plans and state plans are defined in IPSAS 39. Multi-employer plans and state plans can be either defined benefit plans or defined contribution plans. However, for entities providing defined benefit pensions for employees using either a multi-employer or state plan, IPSAS 39 allows entities to use defined contribution accounting if there is insufficient information to use defined benefit accounting. This has the potential to underestimate the obligation owed to employees when that entity applies IPSAS 39. Therefore, the full obligation may not be reported in the employer's financial statements.

AG9. Some retirement benefit plans have sponsors other than employers; this Standard also applies to the financial statements of such plans.

AG10. Most retirement benefit plans are based on formal agreements. Some plans are informal but have acquired obligations as a result of employers' established practices. While some plans permit employers to limit their obligations under the plans, it is usually difficult for an employer to cancel a

[2] Multi-employer plans are defined in IPSAS 39 as defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:

(a) Pool the assets contributed by various entities that are not under common control; and

(b) Use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees.

[3] State plans are defined in IPSAS 39 as plans established by legislation that operate as if they are multi-employer plans for all entities in economic categories laid down in legislation.

plan if employees are to be retained. The same basis of accounting and reporting applies to an informal plan as to a formal plan.

AG11. Some retirement benefit plans provide for the establishment of separate funds into which contributions are made and out of which benefits are paid. Such funds may be administered by parties who act independently in managing fund assets. Those parties are called trustees in some countries. The term trustee is used in this Standard to describe such parties regardless of whether a trust has been formed. Many public sector retirement benefit plans are unfunded, operating on a pay-as-you-go basis whereby benefits are payable from general taxation.

Definitions (see paragraph 9)

AG12. For the purposes of this Standard, defined benefit plans are those plans which do not meet the definition of a defined contribution plan. This includes hybrid plans, which are retirement benefit plans that contain characteristics of both defined benefit plans and defined contribution plans. A defined benefit plan is a retirement benefit plan under which amounts to be paid as retirement benefits are typically determined by reference to a formula usually based on participants' earnings and/or years of service. The extent of the obligation for future retirement benefits is determined by the measurement of the promised retirement benefits and not by the level of contributions. Defined benefit plans might be funded, through plan investments, and where a shortfall arises, the employer/sponsor has a legal or constructive obligation to provide for the additional promised benefits. For unfunded plans, such as those established on a pay-as-you-go basis, all benefits payable will be financed from, for example, general taxation.

AG13. A defined benefit plan usually needs the periodic advice of an actuary to assess the financial condition of the plan, review the assumptions and recommend future contribution levels by employers/sponsors. Because the employer/sponsor is obligated to provide for any shortfall of retirement benefits over plan investments based on these assumptions, any investment risk typically falls on the employer/sponsor.

AG14. The retirement benefit plan accounts for its defined benefit obligation at the present value of the payments expected to settle promised retirement benefits, which it bases on the calculations performed periodically by an actuary. The retirement benefit plan accounts for the plan assets (if any) separately.

AG15. Defined contribution plans differ from defined benefit plans in that the amounts to be paid as retirement benefits are determined by the amount of contributions to a participant's plan together with investment earnings. The extent of the obligation for future retirement benefits is~~,~~ therefore~~,~~ capped by the size of the fund at the reporting date.

AG16. Under a defined contribution plan, the amount of a participant's future benefits is determined by the contributions paid by the employer/sponsor, the participant, or both, and the operating efficiency and investment earnings of the fund. An employer's/sponsor's obligation is usually discharged by contributions to the fund. Therefore, any investment risk typically falls on the participant. An actuary's advice is not normally required although such advice is sometimes used to estimate future benefits that may be achievable based on present contributions and varying levels of future contributions and investment earnings.

Recognition (see paragraphs 10 and 11)

AG17. This Standard requires the obligations to participants to be recognized and presented on the face of the statement of financial position. In a defined benefit plan, the obligation is a provision (a liability of uncertain timing or amount) called "the actuarial present value of promised retirement benefits"; it will generally be calculated by an actuary in accordance with the rules of the plan (e.g., qualifying service and salary) using actuarial assumptions. A hybrid plan will also have defined contribution obligations (see paragraphs 11 and AG18). The responsibility for making good any deficit between the value of any plan assets and the promised retirement benefit obligations may lie with the employer/sponsor of the plan, or with the appropriate level of government, or, in a shared funding arrangement, one or more of the employers/sponsors, depending on the rules of the retirement benefit plan and/or legislation.

AG18. In a defined contribution plan, the amount to be recognized for obligations to participants equate to the net assets less, if required by the rules of the plan or other regulations, any retention for specified purposes (e.g., investment risks).

Measurement (see paragraphs 12–14)

Valuation of Plan Investments

AG19. The term 'plan assets' is an overarching term for all assets of the retirement benefit plan. Plan investments are a subset of plan assets and are those assets that are required specifically for their investment potential to fund payment of retirement benefit obligations.

AG20. This Standard requires all plan investments to be measured at fair value. Any plan investments that are financial instruments shall be measured at fair value in accordance with IPSAS 41, *Financial Instruments.* Other plan investments shall be measured at fair value in accordance with the applicable IPSAS (e.g., IPSAS 16, *Investment Property*). Other plan assets shall be measured in accordance with the applicable IPSAS.

Actuarial Present Value of Promised Retirement Benefits

AG21. The actuarial present value of promised retirement benefits based on projected salaries is disclosed to indicate the magnitude of the potential obligation on a going concern basis which is generally the basis for funding. This obligation reflects the expectation of future benefits determined using actuarial methods, and projected salaries are used because benefits are measured in the future against salaries applicable at the point the benefits become due.

AG22. Actuarial valuations are not always obtained annually; some retirement benefit plan regulations might require actuarial valuations every three or five years, for example. If an actuarial valuation has not been prepared at the date of the financial statements, the most recent valuation is likely to be suitable as a starting point for the current year's valuation. This requires the most recent actuarial valuation to be updated for any material transactions and other material changes in circumstances (including changes in market prices, interest rates, and expected inflation rate of projected salaries) up to the end of the reporting period.

AG23. Because a retirement benefit plan may have different risks and assumptions when compared to the employer/sponsor, an actuarial valuation may result in different valuations of the same defined benefit obligations for the retirement benefit plan and for the employer/sponsor. For example, the discount rate applied by the employer/sponsor may differ from that of the retirement benefit plan as a result of different risks related to the employer/sponsor compared to the plan. When the actuarial valuation performed for the employer/sponsor is used as a base, any necessary adjustments shall be made for determining the obligation of the retirement benefit plan.

Applicability of Other IPSAS

AG24. Unless specifically overwritten by this Standard, all other IPSAS apply to the financial statements of retirement benefit plans when applicable. For example, if a retirement benefit plan is required or elects to make their approved budget(s) publicly available, IPSAS 24, *Presentation of Budget Information in Financial Statements* shall also apply.

Presentation and Disclosure (see paragraphs 15–24)

Presentation of Financial Statements

AG25. This Standard overrides the requirements of IPSAS 1, *Presentation of Financial Statements* by setting out in paragraphs 15 and 16 which financial statements a retirement benefit plan shall present.

Statement of Financial Position

AG26. Plan investments are to be shown on the face of the statement of financial position and suitably classified. This requires grouping assets of a similar nature – for example, as equities, fixed income securities, and investment funds.

AG27. The statement of financial position is required to present the actuarial present value of promised retirement benefits and defined contribution obligation to plan participants below net assets available for benefits. Inclusion of this obligation(s) addresses the principal objective of this Standard to increase the transparency and accountability about retirement benefit plan obligations of public sector entities to participants.

AG28. This line item differs from the presentation of liabilities for benefits due and payable to participants (if applicable). Liabilities for benefits due and payable to participants are shown above the net assets available for benefits and only include those amounts that are immediately payable. For example, it may represent a monthly defined benefit pension payment yet to be paid or a withdrawal from a defined contribution plan requested by the participant that is yet to be paid.

Statement of Changes in Net Assets Available for Benefits

AG29. The line items shown in the statement of changes in net assets available for benefits are only those that are directly attributable to the plan. The nature of those items will largely depend on the terms of a plan. For example, some retirement benefit plans may specify that some administrative costs (such as the salaries of plan's investment managers) are paid out of investment income.

Statement of Changes in Retirement Benefit Obligations or Disclosure of Reconciliation Between the Opening and Closing Retirement Benefit Obligation Balances

AG30. The structure of a retirement benefit plan – such as whether it is a defined benefit plan or defined contribution plan and whether it is funded or pay-as-you-go – may determine how contributions and benefits are accounted for.

AG31. Some retirement benefit plans account for contributions and benefits as revenue and expenses respectively, while others account for contributions and benefits as changes in liabilities to participants. In some cases, the structure of retirement benefit plans might mean that a mixed approach is taken to accounting for contributions and benefits. Depending on the circumstances, the line items for contributions and benefits paid may need to be shown differently on the face of the statement of changes in retirement benefit obligations (see the Illustrative Examples) or in the disclosure of the reconciliation between the opening and closing retirement benefit obligation balances.

Cash Flow Statement

AG32. When preparing the cash flow statement, a retirement benefit plan shall consider the requirements and guidance in IPSAS 2, *Cash Flow Statements.* This Standard requires cash flows to be reported using the direct method, because the structure of the other financial statements makes it unlikely that an annual surplus or deficit will be reported, making the indirect method impracticable.

AG33. Individual retirement benefit plans may treat certain transactions differently. For example, contributions may be revenue or a liability to the participant, depending on the terms of the retirement benefit plan. Therefore, the classification of transactions as operating, investing, or financing cash flows may differ between retirement benefit plans. However, the classification adopted shall be applied consistently by a retirement benefit plan.

Disclosure

AG34. This Standard requires retirement benefit plans to provide a description of the funding policy. This description shall include information about how a retirement benefit plan intends to fund the payment of promised benefits, including the management of any funding deficit which may exist at the reporting date.

AG35. Information about how a plan intends to fund benefit payments may provide useful information to some users about the maturity of the retirement benefit plan. Participants are interested in the activities of the plan since they directly affect the level of their future benefits. Participants are interested in knowing whether contributions have been received and proper control has been exercised to protect their rights. An employer/sponsor is interested in the efficient and fair operation of the plan.

AG36. Information provided in disclosures shall also reveal whether a retirement benefit plan is sufficiently funded. If the retirement benefit plan is unfunded or in deficit, the description of the funding policy shall provide information about how amounts due for promised retirement benefits will be satisfied – for example, by participant contributions or by funds from a central government.

Effective Date and Transition (see paragraphs 25–27)

AG37. This Standard shall be applied prospectively. However, when a retirement benefit plan that has used another international or national accounting standard dealing with retirement benefit plans first applies this Standard, it shall provide restated comparative financial statements in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Appendix B

Amendments to Other IPSAS

Amendments to IPSAS 39, *Employee Benefits*

Paragraph 3 is amended. Paragraph 176D is added. New text is underlined and deleted text is struck through.

Scope

…

3 This Standard does not deal with reporting by ~~employee~~ retirement benefit plans (see ~~the relevant international or national accounting standard dealing with employee retirement benefit plans~~ IPSAS 49, *Retirement Benefit Plans*). This Standard does not deal with benefits provided by composite social security programs that are not consideration in exchange for service rendered by employees or past employees of public sector entities.

…

Effective Date

176D **Paragraph 3 was amended by IPSAS 49, *Retirement Benefit Plans* issued in October, 2023. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2026. Earlier application is permitted. If an entity applies the amendment for a period beginning before January 1, 2026, it shall disclose that fact.**

Amendments to IPSAS 41, *Financial Instruments*

Paragraph AG2 is amended. Paragraph 156H is added. New text is underlined and deleted text is struck through.

Scope

…

AG2. This Standard does not change the requirements relating to retirement benefit plans for public sector employees and other eligible participants that comply with ~~the relevant international or national accounting standard on accounting and reporting by retirement benefit plans~~ IPSAS 49, *Retirement Benefit Plans* and royalty agreements based on the volume of sales or service revenues that are accounted for under IPSAS 9, *Revenue from Exchange Transactions*.

…

Effective Date

156H **Paragraph AG2 was amended by IPSAS 49, *Retirement Benefit Plans* issued in October, 2023. An entity shall apply these amendments for annual financial statements covering periods beginning on or after January 1, 2026. Earlier application is permitted. If an entity applies the amendment for a period beginning before January 1, 2026, it shall disclose that fact.**

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 49.

Objective (see paragraph 1)

BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS 49, *Retirement Benefit Plans*. This Standard is adapted from IAS 26, *Accounting and Reporting by Retirement Benefit Plans* issued by the International Accounting Standards Board (IASB). This Basis for Conclusions outlines those areas where the IPSASB decided to propose requirements for retirement benefit plans in the public sector that differ from those set out in IAS 26.

Background

BC2. The IPSASB's *Strategy and Work Plan 2019-2023* identified a project to develop an IPSAS aligned with IAS 26 as part of Theme B – 'Maintaining alignment with IFRS' which then led to the development of this Standard. The IPSASB approved the Project Brief for this Standard at its March, 2021 meeting.

BC3. Multi-employer plans and state plans are common in the public sector. Because IPSAS 39, *Employee Benefits* allows employers contributing to these types of plans to report on a defined contribution basis, even if they are a defined benefit plan, the IPSASB was of the view that there may be a lack of transparent reporting of these plans' obligations for retirement benefits. The IPSASB noted that, while IPSAS 39 was aligned with IAS 19, *Employee Benefits*, there was no IPSAS equivalent to IAS 26.

BC4. IAS 26 was issued in January 1987 and its objective is to provide the accounting and reporting requirements for arrangements through which an entity provides retirement benefits (for example, an annual income) to employees after they terminate from service. Prior to the issuance of this Standard there were no corresponding requirements in IPSAS for the accounting by retirement benefit plans.

BC5. Therefore, the IPSASB considered it was important to develop a Standard which would require retirement benefit plans to provide a more complete view of the public sector retirement benefit obligation for accountability purposes. Further, because governments are often responsible for funding the deficits of defined benefit plans, this information also supports governments in making fiscal decisions about whether continuing to provide defined benefit pensions (in particular) is sustainable; making such decisions is challenging without easy access to the expected cost of providing retirement benefits in the form of an obligation on the plan's statement of financial position. The IPSASB noted that this Standard complements the requirements in IPSAS 39, and therefore provides the desired information on public sector retirement benefit obligations for each retirement benefit plan that reports under this Standard.

BC6. The IPSASB discussed whether relevant entities should consolidate a retirement benefit plan into a greater economic entity, based on the concepts in IPSAS 35, *Consolidated Financial Statements.* The IPSASB concluded that where the greater economic entity does not control the retirement benefit plan, consolidation under IPSAS 35 is not appropriate. When consolidation is not appropriate, the IPSASB confirmed the principles in IPSAS 39 provide the appropriate information about the totality of public sector retirement benefit obligations in the greater economic entity.

BC7. When discussing the Project Brief, the IPSASB noted that the age of IAS 26 means it is out of step with some of the developments in financial reporting since 1987. The IPSASB concluded that it was likely that some of the options available in IAS 26 would be inappropriate for public sector financial reporting and decided to proceed on the basis that the project would be an adaptation project rather than an alignment project.

BC8. The IPSASB also considered whether the title of this Standard should differ from IAS 26 and decided that the title should be shortened to *Retirement Benefit Plans*.

Scope (see paragraphs 2–8)

BC9. Respondents to Exposure Draft 82, *Retirement Benefit Plans* proposed better aligning the requirements of IPSAS 49 with the requirements in other IPSAS. For example, some respondents suggested aligning the definitions and requirements of IPSAS 49 with those in IPSAS 39, arguing that aligning definitions and requirements would better ensure that key measurements such as the actuarial present value of promised retirement benefits would be consistent and enable balances presented under IPSAS 49 to be consolidated into the employer/sponsor's financial statements when applying IPSAS 35.

BC10. The IPSASB concluded alignment between IPSAS 49 and IPSAS 39 was not necessary for the following reasons:

- Financial information presented using IPSAS 49 provides different information and satisfies different user needs than financial information presented using IPSAS 39. The primary users of financial information provided by IPSAS 49 are participants of the plan. They require information that supports their ability to understand if the retirement benefit plan can fund their retirement. The primary users of the financial information provided by IPSAS 39 are users of the financial information of the employer/sponsor. The financial information provided by IPSAS 39 makes up only a portion in the broader set of the employer's/sponsor's financial statements. These users are concerned with the employer's/sponsor's liability to fund the plan and require the ability to compare that retirement benefit liability with similar entities. The IPSASB concluded different user needs warrant the need for different measurements.
- The requirements of what an employer/sponsor shall include in its financial statements related to a retirement benefit plan are stated in IPSAS 39. IPSAS 49 provides guidance on how to present and measure this balance in a set of financial statements for the retirement benefit plan. Since the retirement benefit liability is already presented in the financial statements of the employer/sponsor, the IPSASB concluded an employer/sponsor is not expected to apply the requirements of this Standard as any pension obligations are captured in its financial statements when applying the requirements of IPSAS 39.

BC11. The IPSASB also discussed whether the scope of this Standard should be expanded to include benefit plans that have similar characteristics to retirement benefit plans but provide benefits more generally to meet societal needs other than solely retirement benefits to public sector employees and other participants who are eligible to join the plan (see paragraph 5 of this Standard). The IPSASB decided to retain the scope of IAS 26 because the primary purpose of the Standard is to provide guidance for accounting and reporting by retirement benefit plans in the public sector. The IPSASB noted that, for plans that have characteristics similar to retirement benefit plans, application of relevant parts of this Standard by analogy could be appropriate under paragraphs 12-15 of IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*. Other schemes may have characteristics that make application of relevant parts of IPSAS 39 or IPSAS 42, *Social Benefits* appropriate.

BC12. The IPSASB also agreed that the retirement benefit plan is the reporting entity; this is consistent with IAS 26. Therefore, entities that administer multiple retirement benefit plans must prepare financial statements for each individual plan.

Definitions (see paragraph 9)

BC13. The IPSASB noted that 'defined benefit plans' and 'defined contribution plans' are already defined in IPSAS 39, *Employee Benefits* but with different definitions to those in IAS 26 and discussed whether the IPSAS 39 definitions should be used in this Standard. The IPSASB decided that the IPSAS 39 definitions were not appropriate because they were written from the perspective of an employer contributing to a retirement benefit plan, whereas the IAS 26 definitions are written from a retirement benefit plan's perspective.

BC14. The IPSASB decided to retain the IAS 26 definition for 'defined contribution plans', with additional guidance noting that for a defined contribution plan it is the participants in the plan who bear the principal investment risk.

BC15. The IPSASB did, however, decide to amend the IAS 26 definition for 'defined benefit plans' from:

"Defined benefit plans are retirement benefit plans under which amounts to be paid as retirement benefits are determined by reference to a formula usually based on participants' earnings and/or years of service"; to

"Defined benefit plans are retirement benefit plans other than defined contribution plans".

BC16. The IPSASB made this change to ensure that all retirement benefit plans that did not meet the definition of a defined contribution plan would be accounted for as a defined benefit plan. It was also decided to include Application Guidance to help distinguish between a defined benefit plan and a defined contribution plan. For example, the guidance indicates that for a defined benefit plan it is the employer/sponsor that bears the principal investment risk.

BC17. The IPSASB considered whether the IAS 26 definition for the 'actuarial present value of promised retirement benefits' should be replaced with the IPSAS 39 definition for the 'present value of defined benefit obligations'. The IPSASB noted that the definitions were written from different perspectives and that the plan perspective is appropriate in this Standard, even if the different perspectives may result in different valuations for fundamentally the same obligation (refer to BC18 below). Therefore, it was decided to retain the IAS 26 definition.

Recognition (see paragraphs 10–11)

BC18. The IPSASB noted that IAS 26 provides three options for defined benefit plans to present information on the actuarial present value of promised retirement benefits: recognition on the face of the financial statements, presentation in the notes to the financial statements, or by reference to an accompanying actuarial report. The IPSASB considers that the actuarial present value of promised retirement benefits is key information and decided that this information shall be recognized on the face of the statement of financial position as a separate provision. The IAS 26 options permitting only disclosure of this information in notes to the financial statements, or in a separate actuarial report, are therefore not included in this IPSAS.

BC19. The IPSASB also noted that IAS 26 is silent on whether or where retirement benefit obligations for defined contribution plans should be recognized and presented in the financial statements of a retirement benefit plan. To improve the accountability and transparency of such plans, the IPSASB decided that defined contribution obligations owed to participants under the terms of the plan shall also be recognized and presented on the face of the statement of financial position. In contrast, the employer's/sponsor's financial statements should not present an obligation related to contributions when there is no liability for unpaid contributions. There are differing views on the precise nature of defined contribution obligations; are they liabilities of uncertain timing and/or amount (and thus be accounted for as provisions); potential distribution to owners; or are they akin to stakeholder' equity? The IPSASB is of the view that the nature of defined contribution obligations may be linked to the design of the defined contribution plans and decided, therefore, not to describe them as any particular element of financial statements.

Measurement (see paragraphs 12–14)

Valuation of Plan Investments

BC20. IAS 26 requires plan investments to be measured at fair value. However, the IPSASB noted that IAS 26 seems to allow plan investments to be measured at another value if an estimate of fair value is not possible. The IPSASB agreed that fair value measurement guidance in other IPSAS is sufficient and decided that plan investments shall be measured at fair value using the guidance in other IPSAS as relevant to the type of plan investments.

Actuarial Present Value of Promised Retirement Benefits

BC21. The IPSASB noted that IAS 26 allows the actuarial present value of promised retirement benefits to be measured using either current salaries or projected salaries. The IPSASB discussed whether it was appropriate to keep both options in this Standard. The IPSASB decided that the option to use current salaries should be removed from this Standard because it has the potential to understate the actuarial present value of promised retirement benefits. Plan participants are interested in the sustainability of the retirement benefit plan and therefore require a best estimate of the present value of future obligations using projected salaries. It was also noted that using projected salaries is consistent with IPSAS 39, under which the present value of a defined benefit obligation is required to be measured using projected salaries. Further, using projected salaries is consistent with the objective of this Standard to increase the transparency and accountability of retirement benefit plans for retirement benefit obligations owing to participants. The IPSASB noted that the benefit of providing an estimate based on projected salaries would outweigh any cost implication to the retirement benefit plan.

BC22. The IPSASB considered including a practical expedient whereby, under certain circumstances, the trustees of a retirement benefit plan could use the employer's/sponsor's actuarial valuation to measure the actuarial valuation of promised retirement benefits for the purposes of this Standard. The IPSASB noted the use of such a practical expedient in some jurisdictions, but also noted that in other jurisdictions regulatory requirements may result in a different measurement for the same obligation, due to, amongst others, the different discount rates applied by actuaries and the impact of collective versus individual participant valuation, especially prevalent in multi-employer plans. The IPSASB is also of the view that if the trustees of a retirement benefit plan considered the IPSAS 39 measurement was appropriate for retirement benefit plan purposes, e.g., there are no material differences in approach, assumptions, or discount rates applied by actuaries, they may use it without needing a practical expedient in this Standard. Therefore, it was decided not to include such a practical expedient.

Classification of Contributions and Benefits

BC23. The IPSASB discussed whether contributions and benefits should be classified as any particular element as defined in the Conceptual Framework. The IPSASB noted that in some jurisdictions contributions are considered to be revenue whereas other jurisdictions are of the view that contributions give rise to an obligation. Similarly, benefits may be considered expenses or a reduction in that obligation depending on the jurisdiction.

BC24. The IPSASB decided that classifying contributions and benefits is dependent on the structure and regulations of a particular retirement benefit plan. The IPSASB acknowledged that there are many different types of retirement benefit plans, and each will have its own nuances regarding structure and regulations. Therefore, because this Standard applies to all types of plans, the IPSASB decided not to classify contributions and benefits as particular elements but instead to leave the classification in financial statements to the judgement of preparers with knowledge of the plan structure and regulations.

Presentation of Financial Statements (see paragraphs 15–21)

BC25. The IPSASB noted that IAS 26 is not definitive about which financial statements a retirement benefit plan should present and decided that this Standard would specify which financial statements are required.

BC26. The IPSASB noted that users of a retirement benefit plan's financial statements are mostly interested in a statement which shows a reconciliation of the opening and closing balances of the net assets available for benefits, which shows the inflows and outflows of the retirement benefit plan and decided that a statement of financial performance would not be required. A reconciliation of the annual performance of the retirement benefit plan is presented in the statement of changes in net assets available for benefits, which does bear some resemblance to a statement of financial performance but should not be considered as such.

BC27. The IPSASB noted that it was unclear whether IAS 26 required a retirement benefit plan to present a cash flow statement. The IPSASB was of the view that retirement benefit plans should include a cash flow statement because it provides important information for users. Therefore, the IPSASB decided that this Standard would specify that a retirement benefit plan shall present a cash flow statement. The cash flow statement shall be prepared using the direct method according to IPSAS 2, *Cash flow Statements*, because this Standard does not require a statement of financial performance. Therefore, it is not suitable to prepare a cash flow statement using the indirect method, because there is no surplus or deficit to adjust for non-cash items to derive net cash flows from operating activities.

Disclosure (see paragraphs 22–24)

BC28. The IPSASB reviewed the IAS 26 disclosure on the valuation of plan assets in, and the funding of, a retirement benefit plan, and agreed with respondents that more information would be useful to the decision-making needs of users of the financial statements, Therefore, the IPSASB agreed to expand the disclosure requirements in the notes to the financial statements of a retirement benefit plan, whether defined benefit or defined contribution, reflected in paragraph 22, as follows:

"(c) The basis for the valuation of all plan assets, including fair value measurement disclosure per class of plan assets as required by the applicable IPSAS"; and

"(g) A description of the funding policy, including any obligations by the employer/sponsor to meet any actuarial determined shortfall in assets in a funded retirement benefit plan".

BC29. The IPSASB further agreed to enhance the application guidance in AG36 regarding the inclusion of disclosure on the funding policy of the retirement benefit plan by referring, for example, to the contributions expected from participants, central government, or another entity.

Effective Date and Transition (see paragraphs 25–27)

BC30. The IPSASB considered that the key information in the General Purpose Financial Statements of a retirement benefit plan comprises the obligation of future benefits, the extent of any deficit, and the change in those figures over the reporting period. The IPSASB concluded that requiring the application of the guidance on the prospective basis would best serve the needs of users of retirement benefit plan information because it enables the retirement benefit plan to provide the information sooner than if retrospective application were required. Prospective application will require a retirement benefit plan to prepare an opening and closing Statement of Financial Position, and other Statements only for the year of adoption. This more quickly achieves one of the project objectives, which was to provide users with a more accurate view of the retirement benefit obligations of public sector entities. Retrospective application would require additional historical information and the key information would not be available as quickly as under prospective application.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 49.

Factors to consider in determining whether contributions and benefits are revenue and expenses or liabilities and a reduction in liabilities.

Q: How do preparers determine the accounting treatment of contribution and benefits?

A: There may be many different retirement benefit plan structures and frameworks even within the same jurisdiction, as well as across jurisdictions. In order to determine the economic substance of the arrangements in each plan, and therefore the most appropriate accounting treatment, the preparers of the retirement benefit plan financial statements should exercise professional judgment in making this determination and consider the following factors:

(a) Characteristics of the plan;

(b) Structure of the plan;

(c) Regulatory environment;

(d) Legislative environment;

(e) Purpose of the contributions;

(f) Types of benefits provided; and

(g) The type of other expenses borne by the plan.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 49.

The following illustrative examples (IE) provide examples of styles and formats for retirement benefit plans to present financial statements that are consistent with IPSAS 49. These IEs are not comprehensive nor mandatory. Other styles and formats are acceptable if they meet the requirements of this IPSAS.

These IEs show three potential ways in which the required financial statements can be presented, depending on the judgment made about how to present contributions and benefits. The different line items in the IEs are illustrative.

IE 1 relates to a *defined benefit plan* where the contributions and benefits are treated as revenue and expenses and all cash flows are treated as operating cash flows.

IE 2 relates to a *defined benefit plan* where the contributions are treated as a liability and the benefits as a reduction in that liability. Regarding cash flows, returns on investments, administrative payments, investment payments, and taxes paid on investment income are operating cash flows. Purchases and sales of plan investments are investing activities. Contributions and benefits, transfers to and from other plans, and income tax on contributions are financing activities.

IE 3 relates to a *defined contribution plan* where the contributions and benefits are treated as revenue and expenses. Regarding cash flows, return on investments, administrative payments, contributions received, benefits paid (and associated receipts and payments), and income taxes are operating activities. Purchases and sales of plan investments are investing activities.

Statement of financial position **As at December 31, 20XY** (in thousands of currency units)	**IE1** **(DB)**	**IE2** **(DB)**	**IE3** **(DC)**
Assets			
Cash and cash equivalents	X	X	X
Plan investments (suitably classified)	X	X	X
Accrued interest and dividends receivable	X	X	X
Contributions receivable	X	X	X
Other assets	X	X	X
Total Assets	**X**	**X**	**X**

Statement of financial position **As at December 31, 20XY** (in thousands of currency units)	**IE1** **(DB)**	**IE2** **(DB)**	**IE3** **(DC)**
Liabilities			
Payables	X	X	X
Benefits due and payable	X	X	X
Income tax payable	X	X	X
Other liabilities	X	X	X
Total liabilities excluding benefit obligations to participants	**X**	**X**	**X**
Net assets available for retirement benefits	**X**	**X**	**X**
Provision for the actuarial present value of promised retirement benefits	**X**	**X**	**N/A**
Defined contribution obligation	**N/A**[4]	**N/A**[5]	**X**
Other reserves	X	X	X
Excess or deficit of funding	**X**	**X**	**X**

4 If this was a hybrid plan there would also be an amount for defined contribution obligations

5 As for footnote 4

Statement of changes in net assets available for benefits For the year ended December 31, 20XY (in thousands of currency units)	**IE1** **(DB)**	**IE2** **(DB)**	**IE3** **(DC)**
Net assets available for benefits (beginning of the year)	**X**	**X**	**X**
Investment earnings			
Net change in fair value of plan investments	X	X	X
Interest revenue	X	X	X
Investment revenue	X	X	X
Dividend revenue	X	X	X
Other revenue	X	X	X
	X	**X**	**X**
Contributions			
Employer	X	X	X
Participant	X	X	X
Benefits accrued	X	X	N/A
Funding from sponsor[6]	X	X	X
Total increase in net assets available for benefits	**X**	**X**	**X**
Benefits paid	X	X	X
Investment related expenses	X	X	X
Operational and administrative expenses	X	X	X
Other expenses	X	X	X
Tax on income	X	X	X
Total decrease in net assets available for benefits	**X**	**X**	**X**
Transfers to and from other plans	X	X	X
Net increase/decrease in assets available for benefits	**X**	**X**	**X**
Net assets available for benefits (end of the year)	**X**	**X**	**X**

[6] This funding is generally related to unfunded plans and may be made by, for example, a central government. It is separate from contributions from the employer.

Statement of changes in retirement benefit obligations **For the year ended December 31, 20XY** (in thousands of currency units)	**IE1** **(DB)**	**IE2** **(DB)**	**IE3** **(DC)**
Retirement benefit obligations (beginning of the year)	**X**	**X**	**X**
Contributions			
Employer	N/A	X	X
Participant	N/A	X	X
Funding from sponsor	N/A	X	X
Transfers from other plans	X	X	X
Changes in actuarial assumptions	X	X	N/A
Benefits accrued	X	X	N/A
Total increase in retirement benefit obligations	**X**	**X**	**X**
Benefits paid	X	X	X
Transfers to other plans	X	X	X
Tax on contributions	N/A	X	X
Total decrease in retirement benefit obligations	**X**	**X**	**X**
Retirement benefit obligations (end of the year)	**X**	**X**	**X**

NOTE: As an alternative to the statement of changes in retirement benefit obligations, this information can be provided in the notes to the financial statements.

Cash flow statement **For the year ended December 31, 20XY** (in thousands of currency units)	**IE1** **(DB)**	**IE2** **(DB)**	**IE3** **(DC)**
Cash flows from operating activities			
Receipts			
Sale of plan investment	X	N/A	N/A
Interest received	X	X	X
Dividends received	X	X	X
Other receipts	X	X	X
Employer contributions received	X	N/A	X
Participant contributions received	X	N/A	X
Funding received from sponsor[7]	X	N/A	X
Payments			
Purchase of plan investments	X	N/A	N/A
Investment related payments	X	X	N/A
Participant benefits paid	X	N/A	X
Operational and administrative payments	X	X	X
Other payments	X	X	X
Tax paid on contributions	X	N/A	X
Tax paid on investments	X	X	X
Transfers to and from other plans	X	N/A	N/A
Net cash inflows (outflows) from operating activities	**X**	**X**	**X**
Cash flows from investing activities			
Purchase of plan investments	N/A	(X)	(X)
Sale of plan investment	N/A	X	X
Investment related expenses	N/A	N/A	X
Transfers to and from other plans	N/A	N/A	X
Net cash inflows (outflows) from investing activities	**N/A**	**X**	**X**

7 This funding is generally related to unfunded plans and may be made by, for example, a central government. It is separate from contributions from the employer.

Cash flow statement **For the year ended December 31, 20XY**	**IE1**	**IE2**	**IE3**
(in thousands of currency units)	**(DB)**	**(DB)**	**(DC)**
Cash flows from financing activities			
Employer contributions received	N/A	X	N/A
Participant contributions received	N/A	X	N/A
Funding received from sponsor[8]	N/A	X	N/A
Participant benefits paid	N/A	X	N/A
Transfers to and from other plans	N/A	X	N/A
Tax paid on contributions	N/A	(X)	N/A
Net cash inflows (outflows) from financing activities	**N/A**	**X**	**N/A**
Net increase (decrease) in cash and cash equivalents	**X**	**X**	**X**
Cash and cash equivalents at the beginning of the year	X	X	X
Cash and cash equivalents at the end of the year	**X**	**X**	**X**

8 This funding is generally related to unfunded plans and may be made by, for example, a central government. It is separate from contributions from the employer.

Comparison with IAS 26

IPSAS 49, *Retirement Benefit Plans* is drawn from IAS 26, *Accounting and Reporting by Retirement Benefit Plans*, including amendments up to February 2021.

The main differences between IPSAS 49 and IAS 26 are as follows:

- IPSAS 49 has different definitions, such as defined benefit plans and net assets available for benefits;
- IPSAS 49 requires the use of projected salaries only when measuring the actuarial present value of promised retirement benefits, while IAS 26 permits a choice of using current salary levels or projected salary levels; and
- IPSAS 49 requires the presentation of a cash flow statement for retirement benefit plans, while IAS 26 does not.

Comparison with GFS

In developing IPSAS 49, *Retirement Benefit Plans,* the IPSASB considered Government Finance Statistics (GFS) reporting guidelines.

Key similarities with GFS are as follows:

- IPSAS 49 permits contributions to the retirement benefit plans to be accounted for as either revenue or a liability to the participant, depending on the terms of the plan, and GFS also permits this depending on the type of scheme.
- IPSAS 49 requires retirement benefit obligations to be recognized in the statement of financial position. Similarly, GFS also requires pension entitlements to be presented on the balance sheet.

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