

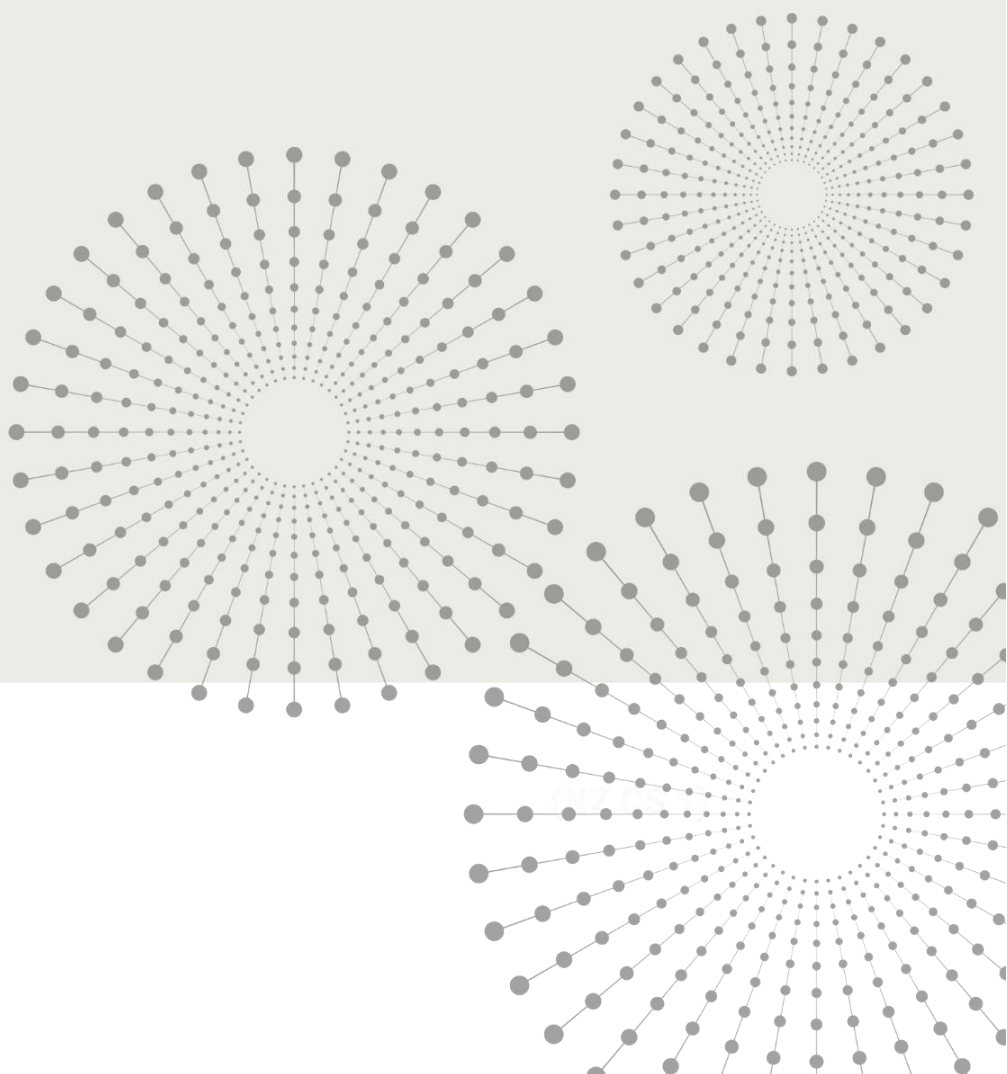
# PBE Conceptual Framework Update

Proposed amendments to Chapter 3 *Qualitative Characteristics*  
and Chapter 5 *Elements in General Purpose Financial Reports*

**Exposure Draft**

**Submissions close 21 June 2024**

March 2024





## NZASB EXPOSURE DRAFT 2024-1

### **PBE Conceptual Framework Update – Amendments to Chapter 3 *Qualitative Characteristics* and Chapter 5 *Elements in General Purpose Financial Reports***

#### **Issued [date]**

This [draft] Authoritative Notice amends Chapter 3 and Chapter 5 of the *Public Benefit Entities' Conceptual Framework*, based on amendments issued by the International Public Sector Accounting Standards Board (IPSASB). Amendments include updates to the guidance on materiality, clarification of the role of prudence in the context of faithful representation, updates to the definitions of an asset and a liability and the related guidance, and new guidance on the unit of account and on binding arrangements that are equally unperformed.

In finalising this [draft] Authoritative Notice, 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 Authoritative Notice**

This [draft] Authoritative Notice was issued on [date] by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(c) of the Financial Reporting Act 2013.

This [draft] Authoritative Notice is secondary legislation for the purposes of the Legislation Act 2019.

The [draft] Authoritative Notice, pursuant to section 27(1) of the Financial Reporting Act 2013, takes effect on the 28<sup>th</sup> day after the date of its publication. The Authoritative Notice was published under the Legislation Act 2019 on [date] and takes effect on [date].

#### **Commencement and application**

The [draft] Authoritative Notice has a mandatory date of [1 January 2028], meaning it must be applied for accounting periods that begin on or after this date (see Part B and Appendix A for more information).

Application to an earlier accounting period is permitted for accounting periods that end after this [draft] Authoritative Notice takes effect – refer to paragraphs A2–A5 of this [draft] Authoritative Notice.

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The following is available on the XRB website as additional material:

**IPSASB BASIS FOR CONCLUSIONS**

## Part A – Introduction

This Authoritative Notice amends Chapter 3 *Qualitative Characteristics* and Chapter 5 *Elements in General Purpose Financial Reports of the Public Benefit Entities' Conceptual Framework*, based on the IPSASB's updates to Chapters 3 and 5 of its Conceptual Framework.

Amendments include updates to the guidance on materiality, clarification of the role of prudence in the context of faithful representation, updates to the definitions of an asset and a liability and to the related guidance, and new guidance on the unit of account and on binding arrangements that are equally unperformed.

## Part B – Scope

**This Authoritative Notice applies to Tier 1, Tier 2 and Tier 3 public benefit entities to the same extent that the *Public Benefit Entities' Conceptual Framework* (PBE Conceptual Framework) applies to such entities, as explained below.**

This Authoritative Notice amends the PBE Conceptual Framework. The PBE Conceptual Framework establishes the concepts to be applied by the NZASB in developing Public Benefit Entity Standards (PBE Standards), which apply to Tier 1 and Tier 2 public benefit entities. The PBE Conceptual Framework does not override the requirements of PBE Standards. However, the PBE Conceptual Framework's roles include assisting preparers of general purpose financial reports that apply PBE Standards. For example, it may assist preparers in developing consistent accounting policies when dealing with topics that have yet to form the subject of a PBE Standard, or when a Standard allows a choice of accounting policy. In addition, in certain circumstances, public benefit entities applying *Reporting Requirements for Tier 3 Not-for-Profit Entities* (Tier 3 (NFP) Standard) or *Reporting Requirements for Tier 3 Public Sector Entities* (Tier 3 (PS) Standard) may also refer to, and consider the applicability of the definitions and concepts in the PBE Conceptual Framework, to the extent that they do not conflict with those Standards.

## Part C – Amendments to the *Public Benefit Entities’ Conceptual Framework*

### Chapter 3 *Qualitative Characteristics*

Paragraphs 3.14A and 3.14B are added. Paragraph 3.32 is amended and part of the paragraph is relocated to new paragraph 3.33A. Paragraphs 3.10–3.14, 3.15–3.16 and 3.33–3.34 are not amended, but are included for context. New text is underlined, deleted text is struck through, and relocated text is double-underlined.

[...]

#### **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 performance 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 judgement that is to be made, or to induce particular behaviour.
- 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 behaviour. 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 judgements 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 judgement. 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 entity, 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 providing particular services 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.

[...]

## **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 to ~~could~~ 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. ~~GPFRs may encompass qualitative and quantitative information about service performance achievements during the reporting period, and expectations about service performance objectives and financial outcomes in the future. Consequently, it is not possible to specify a uniform quantitative threshold at which a particular type of information becomes material.~~
- 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 performance achievements during the reporting period, and expectations about service performance objectives 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 PBE Conceptual Framework. In developing PBE Standards, the NZASB 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 PBE Standard, 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.

## Chapter 5 *Elements in General Purpose Financial Reports*

Paragraphs 5.8–5.10, 5.13, 5.14, 5.15, 5.17, 5.31 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, 5.26A–5.26J and headings above paragraphs 5.7A, 5.8, 5.26A, and 5.26I are added. The content of paragraphs 5.18–5.23 is relocated as new paragraphs 5.15A–5.15F, with paragraphs 5.15A–5.15C being amended, and paragraphs 5.24–5.26 are relocated as new paragraphs 5.17B–5.17D and amended. Paragraphs 5.7, 5.16, 5.18–5.26, and the headings above paragraphs 5.13, 5.15A, 5.18 and 5.23 are deleted. Paragraphs 5.1, 5.2, 5.3, 5.5, 5.11–5.12, 5.26.1–5.26.2, and 5.29–5.30 are not amended, but are included for context. 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 service performance reports and provides further explanation about those definitions.

[...]

#### Elements of Financial Statements 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 GPFs.

5.3 The elements defined in this Chapter do not refer to the individual items that are recognised 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*.

[...]

#### Elements of Financial Statements Defined

5.5 The elements that are defined in this Chapter are:

- Assets;
- Liabilities;
- Equity;
- 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:

- (a) Rights (paragraphs 5.7A-5.7G);
- (b) Service potential and economic benefits (paragraphs 5.8-5.10); and
- (c) Present control as a result of past events (paragraph 5.11-5.13).

### **A Resource**

~~5.7 [Deleted by IPSASB] 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 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;~~
- ~~• Use an external party's resources to provide services, for example, leases;~~
- ~~• Convert the resource into cash through its disposal;~~
- ~~• Benefit from the resource's appreciation in value; or~~
- ~~• Receive a stream of cash flows.~~

### **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<sup>1</sup>;
  - (iii) Rights to exchange resources with another party on favourable terms. Such rights include, for example, a forward contract to buy a resource on terms that are currently favourable; 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 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.

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<sup>1</sup> Subsequent references to 'services' in the PBE Conceptual Framework encompass 'goods' unless the context indicates otherwise.

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 net cash inflows.

5.9 Assets that embody service potential may include recreational, heritage, community, defence and other assets ~~which that~~ that are held by public benefit 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 specialised 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; or
- 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 a Past Event**

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 performance 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 ability 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 one or more past transactions or other past events. The 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~~ licences 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 of~~ to transfer resources that results from as a result of a past event.*

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 benefit 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 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 PBE Conceptual Framework. For some types of non-exchange transactions, judgement 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 PBE 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 – A Transfer of Resources from the Entity**

~~5.16 [Deleted by IPSASB] 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.~~

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 unfavourable terms. Such obligations include, for example, a forward contract to sell on terms that are currently unfavourable 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), 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 past transactions or other past events and has the potential to require an outflow of resources the entity to transfer resources from the entity. The complexity of the activities of public benefit entities means that a number of events in the development, implementation and operation of a particular activity 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 considers the relevant context.

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 ; 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 new policy or service:

- Making a political promise such as an electoral pledge;
- Announcement of a policy;
- Introduction (and approval or adoption) of the plan or budget (which may be two distinct points);
- Obtaining legal authority to take a proposed action; and
- An appropriation becoming effective.

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. 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 judgements whether other parties can validly conclude that the obligation is such that the entity has little or no realistic alternative to avoid an outflow a transfer 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 crystallises. 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 benefit entity is not legally obliged to incur an outflow a transfer 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 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 [Deleted by IPSASB] 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.
- 5.19 [Deleted by IPSASB] 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.

#### **Legal Obligations**

- 5.20 [Deleted by IPSASB] 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 PBE Conceptual Framework. For some types of non-exchange transactions, judgement 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.
- 5.21 [Deleted by IPSASB] 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.
- 5.22 [Deleted by IPSASB] 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 PBE 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

5.23 ~~[Deleted by IPSASB] 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.~~

5.24 ~~[Deleted by IPSASB] In the public sector, obligations may arise at a number of points. For example, in implementing a new policy or service:~~

- ~~• Making a political promise such as an electoral pledge;~~
- ~~• Announcement of a policy;~~
- ~~• Introduction (and approval or adoption) of the plan or budget (which may be two distinct points);~~
- ~~• Obtaining legal authority to take a proposed action; and~~
- ~~• An appropriation becoming effective.~~

~~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.~~

5.25 ~~[Deleted by IPSASB] 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 judgements 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 crystallises. 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.~~

5.26 ~~[Deleted by IPSASB] “Economic coercion”, “political necessity” or other circumstances may give rise to situations where, although the public benefit 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.~~

## Assets and Liabilities

### Unit of Account

- 5.26A 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.
- 5.26B 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 recognised 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.
- 5.26C 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.
- 5.26D 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 recognise and measure them separately.
- 5.26E 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 recognising 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.
- 5.26F 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.
- 5.26G 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.
- 5.26H 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 recognises 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**

- 5.26I 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 favourable; it has a liability if the terms of the exchange are currently unfavourable. 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).
- 5.26J To the extent that either party fulfils 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.

## **Equity**

### **Definition**

5.26.1 Equity is:

*The residual interest in the assets of the entity after deducting all its liabilities.*

5.26.2 Although equity is defined as a residual, it may be sub-classified in the statement of financial position. For example, funds contributed by owners, accumulated surpluses and reserves relating to revaluations may be shown separately. Such classifications can be relevant to the decision-making needs of the users of financial statements when they indicate legal, regulatory or other restrictions on the ability of the entity to distribute its equity. They may also reflect the fact that parties with ownership interests in an entity have differing rights in relation to the distribution of surpluses or the repayment of capital.

[...]

## **Revenue and Expense**

### **Definitions**

5.29 Revenue is:

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

5.30 Expense is:

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

5.31 Revenue and expense arise from exchange and non-exchange transactions, other events such as unrealised 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.

Part B of the PBE Conceptual Framework, which was previously located after the Basis for Conclusions, is relocated to appear before the Basis for Conclusions, and is renamed as Appendix A. The existing paragraph is numbered as A1 and the heading above that paragraph is amended. Paragraphs A2–A5 are added. New text is underlined and deleted text is struck through.

## **Part B-Appendix A**

*This Appendix is an integral part of the Public Benefit Entities' Conceptual Framework.*

### **Effective Date-Commencement and Application**

A1 This Authoritative Notice [...].

### **PBE Conceptual Framework Update – Amendments to Chapter 3 Qualitative Characteristics and Chapter 5 Elements in Financial Statements**

A2 The amending Authoritative Notice *PBE Conceptual Framework Update – Amendments to Chapter 3 Qualitative Characteristics and Chapter 5 Elements in Financial Statements*, published in [date], amended Chapter 3 and Chapter 5 as follows:

- (a) In Chapter 3, added paragraphs 3.14A and 3.14B, amended paragraph 3.32 and relocated part of this paragraph to new paragraph 3.33A.
- (b) In Chapter 5:
  - (i) amended paragraphs 5.8–5.10, 5.13, 5.14, 5.15, 5.17, 5.31 and the headings above paragraphs 5.11, 5.15, 5.16;
  - (ii) added paragraphs 5.6A, 5.6B, 5.7A–5.7G, 5.12A, 5.14A, 5.16A–5.16F, 5.17A, 5.26A–5.26J and headings above paragraphs 5.7A, 5.8, 5.26A, and 5.26I;
  - (iii) relocated the content of paragraphs 5.18–5.23 and 5.24–5.26 to new paragraphs 5.15A–5.15F and 5.17B–5.17D respectively, and amended paragraphs 5.15A–5.15C and 5.17B–5.17D ;
  - (iv) deleted paragraphs 5.7, 5.16, 5.18–5.26, and the headings above 5.13, 5.15A, 5.18 and 5.23.

An entity shall apply those amendments in accordance with the commencement and application date provisions in paragraphs A3–A5. An entity that applies those amendments to an 'early adoption accounting period' shall disclose that fact.

### **When amending Authoritative Notice takes effect (section 27 Financial Reporting Act 2013)**

A3 The amending Authoritative Notice takes effect on the 28th day after the date of its publication under the Legislation Act 2019. The amending Authoritative Notice was published on [date] and takes effect on [date].

### **Accounting period in relation to which Authoritative Notices commence to apply (section 28 Financial Reporting Act)**

A4 The accounting periods in relation to which this amending Authoritative Notice 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**.

A5 In paragraph A4:

**early adopter** means a reporting entity that applies this amending Authoritative Notice 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 Authoritative Notice takes effect (and to avoid doubt, that period may have begun before this amending Authoritative Notice takes effect); and
- (b) for which the early adopter:
  - (i) first applies this amending Authoritative Notice in preparing its financial statements; and
  - (ii) discloses in its financial statements for that accounting period that this amending Authoritative Notice has been applied for that period.

**mandatory date** means 1 January 2028.

In the NZASB Basis for Conclusions, paragraphs BC10A–BC10C and BC17A–BC17M are added. New text is underlined.

## **Basis for Conclusions**

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

[...]

## **Chapter 3 Qualitative Characteristics**

[...]

### **PBE Conceptual Framework Update (2024)**

BC10A. In 2023, the IPSASB updated Chapter 3 and Chapter 5 of its Conceptual Framework, in light of:

- (a) the IPSASB’s experience in applying the Conceptual Framework to the development and maintenance of accounting standards; and
- (b) developments in international thinking about conceptual issues since the IPSASB Conceptual Framework was approved in 2014 – specifically, the IASB’s *Conceptual Framework of Financial Reporting* as issued in 2018 (IASB 2018 Conceptual Framework) and other amendments made by the IASB to its Conceptual Framework in 2018.

BC10B. The IPSASB’s amendments to Chapter 3, issued by the IPSASB in October 2023, are outlined below. More information on the IPSASB’s decisions is included in the IPSASB’s Basis for Conclusions accompanying Chapter 3 of its Conceptual Framework, available through a link on [www.xrb.govt.nz](http://www.xrb.govt.nz).

(a) **Clarification of the role of prudence in the context of faithful representation**

In the IPSASB’s Conceptual Framework as issued in 2014, and in the PBE Conceptual Framework as issued in 2016, the guidance on qualitative characteristics did not refer to prudence. This was consistent with the IASB’s approach at the time. In issuing the IASB 2018 Conceptual Framework, the IASB reaffirmed its decision not to refer to prudence as a qualitative characteristic – but it added a description of prudence and guidance on how prudence supports neutrality, which is an aspect of faithful representation. The IPSASB considered this guidance to be relevant for the public sector, and amended Chapter 3 of its Conceptual Framework.

(b) **Amendments to the guidance on materiality**

In 2018, the IASB issued *Definition of Material*, to resolve difficulties faced by reporting entities in making materiality judgments, and to align definitions in IASB literature. *Definition of Material* included amendments to the IASB 2018 Conceptual Framework. These amendments supplemented the existing guidance on materiality by adding a reference to ‘obscuring’ information, and softened the threshold for determining when information is material, by referring to reasonable expectation. The IPSASB considered that the IASB’s amendments were relevant for the public sector, and amended Chapter 3 of its Conceptual Framework.

BC10C. The NZASB agreed that the IPSASB’s clarification of the role of prudence and amendments to the guidance on materiality were relevant to public benefit entities in New Zealand. The NZASB issued equivalent amendments to the PBE Conceptual Framework in [date].

[...]

## **Chapter 5 Elements in General Purpose Financial Reports**

[...]

### **PBE Conceptual Framework Update (2024)**

BC17A. In 2023, the IPSASB updated Chapter 3 and Chapter 5 of its Conceptual Framework. The key drivers of this IPSASB project are explained in paragraph BC10A above. The paragraphs that follow outline the IPSASB’s updates to Chapter 5, issued by the IPSASB in May 2023, and discuss the incorporation of these updates into the PBE Conceptual Framework. The NZASB issued the amendments to Chapter 5 in

[date]. More information on the IPSASB's decisions is included in the IPSASB's Basis for Conclusion accompanying Chapter 5 of its Conceptual Framework, available through a link on [www.xrb.govt.nz](http://www.xrb.govt.nz).

Updates relating to the definition of an asset

BC17B. Key updates made by the IPSASB in relation to the definition of an asset include the following.

(a) **Definition of an asset – reference to past events:**

In the definition of an asset, the IPSASB replaced the reference to past event (singular) with 'past events' (plural), to reflect that an asset may arise from a single past event or multiple past events. This amendment is aligned with the IASB 2018 Conceptual Framework.

(b) **Definition of a resource – rights-based approach**

The IPSASB Conceptual Framework and PBE Conceptual Framework previously described a resource – which is an element of the definition of an asset – as “an item with service potential or the ability to generate economic benefits”. The related guidance referred to service potential or economic benefits arising either from the resource itself, or from rights to use it. In considering the changes introduced by the IASB 2018 Conceptual Framework, the IPSASB agreed with the IASB's argument that the guidance on assets should not distinguish between benefits that arise from owning an object (or 'item') 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*, rather than separate phenomena. Consequently, in updating Chapter 5 of its Conceptual Framework, the IPSASB adopted a rights-based approach to the description of a resource and related guidance. The IPSASB amended the description of a resource to: “a right to either service potential or the capability to generate economic benefits, or a right to both”. The IPSASB also added guidance on rights, based on the guidance in the IASB 2018 Conceptual Framework. However, unlike the IASB, the IPSASB has referred to both economic benefits and service potential in the updated description of a resource and in the related guidance.

Updates relating to the definition of a liability

BC17C. Key updates made by the IPSASB in relation to the definition of a liability include the following.

(a) **Definition of a liability – transfer of resources**

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*. The IASB made a similar amendment to the definition of a liability in its 2018 Conceptual Framework. The IASB noted that 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 2018 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, and made similar amendments to the definition of a liability and related guidance in its Conceptual Framework, with modifications to reflect the public sector context. The amended guidance on the definition of a liability includes new guidance on the concept of 'transfer of resources', which is more extensive than the previous guidance on 'outflow of resources'.

(b) **Definition of a liability – reference to past events**

Consistently with the change to the definition of an asset, in the definition of a liability, the IPSASB replaced the reference to past event (singular) with 'past events' (plural). See paragraph BC17B(a).

(c) **Rearrangement of the section on the definition of a liability**

The IPSASB rearranged the section on liabilities in Chapter 5, so that the order of topics discussed in the guidance are aligned with the new definition of a liability.

Unit of account and binding arrangements that are equally unperformed

BC17D. The IPSASB added the following new guidance into Chapter 5 of its Conceptual Framework.

**(a) Unit of account:**

The ‘unit of account’ is the unit to which recognition criteria and measurement concepts are applied. When originally issued, the IPSASB Conceptual Framework and the PBE Conceptual Framework did not contain specific guidance on the ‘unit of account’. As part of its 2023 updates to its 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 2018 Conceptual Framework.

**(b) Binding arrangements that are equally unperformed**

The IPSASB added into Chapter 5 of its Conceptual Framework new guidance on ‘binding arrangements that are equally unperformed’. This guidance is based on the IASB’s guidance on executory contracts in the IASB 2018 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.

NZASB considerations

BC17E. In considering the IPSASB’s amendments to Chapter 5 of its Conceptual Framework, the NZASB discussed potential concerns relating to the IPSASB’s updates to the guidance on the definition of a liability, and the lack of enhancements to the guidance on recognition, as explained below. For most preparers of PBE financial reports, these concerns are expected to apply only in limited circumstances, given that preparers typically refer to the PBE Conceptual Framework in considering whether to recognise a liability (or an asset) for transactions that are not specifically covered by individual Standards. Nevertheless, to assist those preparers that refer to the PBE Conceptual Framework in preparing financial reports, the paragraphs that follow describe the concerns that the NZASB considered and how the NZASB mitigated these concerns.

BC17F. In the IPSASB’s amended guidance on the definition of a liability, paragraphs 5.16A and 5.16B emphasise that the definition of a liability can be met even when the probability of a transfer of resources is low – and that while an obligation must have the potential to require the entity to transfer resources to meet the definition of a liability, the transfer need not be likely and may be required only if an unspecified future event occurs.

BC17G. The NZASB acknowledged that the paragraphs mentioned above are intended to avoid conflating the definition of a liability with the recognition criteria (and measurement requirements) for liabilities, and are aligned with the IASB 2018 Conceptual Framework.

BC17H. However, in issuing the IASB 2018 Conceptual Framework, the IASB also enhanced the guidance on recognition of liabilities and assets – whereas the IPSASB did not incorporate similar enhanced guidance on recognition into its Conceptual Framework. In the IPSASB Conceptual Framework, Chapter 6 *Recognition in Financial Statements* includes general references to the need to consider the qualitative characteristics and uncertainty around the existence of an element in making recognition decisions. The same applies to Chapter 6 of the PBE Conceptual Framework. By contrast, Chapter 5 of the IASB’s Conceptual Framework includes specific sections on considering relevance and faithful representation when determining whether a liability (or an asset) is recognised – including specific discussion on low probability of outflow (and inflow) of economic resources.

BC17I. The paragraphs on recognition in the IASB Conceptual Framework that the NZASB considered of most relevance, particularly in considering whether to recognise a liability where the probability of a transfer of resources is low, are set out below (noting that these paragraphs refer to for-profit terminology, e.g. ‘income’ rather than ‘revenue’, and that where these paragraphs refer to inflows and outflows of economic benefit, a PBE would need to also consider service potential).

**Recognition criteria**

[...]

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).

[...]

### **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.

BC17J. The NZASB considered the following potential concerns associated with including in the PBE Conceptual Framework the new IPSASB paragraphs 5.16A and 5.16B, which emphasise that the definition of a liability can be met even when the probability of a transfer/outflow of resources is low, without enhancing the guidance on the recognition of liabilities in the PBE Conceptual Framework.

- (a) Potential lack of clarity as to whether obligations with low probability of resource transfer should be recognised in the financial statements. The NZASB received feedback that while the PBE Conceptual Framework does not override requirements in PBE Standards, and several PBE Standards require an outflow of resources to be probable for recognition to occur, it would be unhelpful if the PBE Conceptual Framework indicated otherwise.
- (b) Potential perception that the recognition of liabilities and assets is intended to work differently for public benefit entities as compared to for-profit entities, which is not the intended outcome.

BC17K. On balance, the NZASB decided that referring to the enhanced guidance on recognition from the IASB's 2018 Conceptual Framework in the Basis for Conclusions accompanying the PBE Conceptual Framework (see paragraph BC17I above), and discussing this decision in the Basis for Conclusions, is a sufficient and appropriate way to address the concerns outlined above and assist those entities that refer to the PBE Conceptual Framework in preparing financial reports. Specifically:.

- (a) The NZASB considers that the IASB Conceptual Framework under paragraph BC17I may be relevant and useful for PBE preparers when accounting for transactions that are not specifically addressed by individual standards. In such situations, considering this IASB guidance may mitigate the concern about the lack of clarity regarding recognition of liabilities where the probability of a transfer of resources is low – and help avoid an unintended difference in outcomes in relation to the recognition of liabilities for PBEs as compared to for-profit entities.
- (b) At the same time, it is important to safeguard the coherence of the PBE Conceptual Framework, due to its fundamental role in underpinning the development and maintenance of the entire suite of PBE Standards. As the core text of the PBE Conceptual Framework is closely based on the IPSASB Conceptual Framework, there is a risk that incorporating guidance from a different Conceptual Framework into its core text (and adapting this guidance for public benefit entity-specific concepts) could negatively affect coherence and lead to unintended consequences.
- (c) PBE IPSAS 3 states that when developing accounting policies in the absence of a PBE Standard that specifically applies to a transaction or event, in addition to considering other PBE Standards and the PBE Conceptual Framework, management may also consider the most recent pronouncements of other standard-setting bodies, including the IASB. Referring to the enhanced recognition guidance from the IASB Conceptual Framework in the Basis for Conclusions of the PBE Conceptual Framework, included under paragraph BC17J, would help indicate to PBE preparers that this IASB guidance is appropriate to consider in conjunction with the core text of the PBE Conceptual Framework, when developing accounting policies for transactions that are not specifically addressed by individual accounting standards.

BC17L. In reading the IASB's references to inflows and outflows of economic benefit, PBE preparers would also need to consider service potential, take into account differences in terminology between the IASB Conceptual Framework and the PBE Conceptual Framework (e.g. 'income' vs 'revenue'), etc.

BC17M. Having mitigated the concerns discussed in the previous paragraphs, the NZASB considered that the IPSASB's amendments to Chapter 5 are relevant to public benefit entities in New Zealand and incorporated equivalent amendments into the PBE Conceptual Framework.