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IPSAS®

Conceptual Framework Update

Chapter 5, *Elements in Financial Statements*

IPSASB

International Public
Sector Accounting
Standards Board®

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CHAPTER 5, ELEMENTS IN FINANCIAL STATEMENTS

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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 services⁶;~~
- ~~• 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 services¹;
 - (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:

- (f) Settle the obligation by negotiating a release from the obligation;
- (g) Transfer the obligation to a third party; or
- (h) 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 action²; 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:

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

- 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 these 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 paragraphs 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 ability³ 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 GPFs. 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:

- 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;
- 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

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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