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Submitted via website

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Comments to IPSASB's
ED 81 "Conceptual Framework Update: Chapter 3, Qualitative Characteristics and Chapter 5, Elements in Financial Statements"

Dear Mr. Carruthers,

We are pleased to contribute to the improvement of the IPSASB's ED 81 "Conceptual Framework Update: Chapter 3, Qualitative Characteristics and Chapter 5, Elements in Financial Statements" by responding to the following specific matter for comments:

SMC 1: Prudence

In paragraphs 3.14A and 3.14B, the IPSASB has provided guidance on the role of prudence in supporting neutrality, in the context of the qualitative characteristic of faithful representation. Paragraphs BC3.17A - BC3.17E explain the reasons for this guidance. Do you agree with this approach? If not, why not? How would you modify these paragraphs?

We would suggest that the IPSASB gives more prominence to asymmetric prudence in the Conceptual Framework. An analysis of the measurement requirements of IPSASs in relation to asymmetric prudence shows that asymmetric prudence can be found in terms of measurement in a significant number of standards . Annex 1 to this comment letter shows a total of 14 standards where asymmetric prudent requirements have been identified in IPSASs. Against this background, we see a risk that the role of asymmetric prudence is not sufficiently reflected in the CF which may lead to inconsistencies between IPSASB's Conceptual Framework and IPSASs at standards level. We suggest that the IPSASB considers the rationale for standards-level asymmetric requirements in light of its current conceptual thinking. In para. 3.14B of ED 81 it is stated that "Particular standards may contain asymmetric requirements where this is a consequence of decisions intended to select the most relevant information that faithfully represents what it purports to present". As there could be conflicts between the QC of faithful representation and the asymmetric prudence principle, we encourage the IPSASB to assess the measurement requirements in Annex 1 in light of the QC of faithful presentation and the asymmetric prudence principle.

SMC 2: Obscuring Information as a Factor Relevant to Materiality Judgments
In discussing materiality in paragraph 3.32 the IPSASB has added obscuring information to misstating or omitting information as factors relevant to materiality judgments. The reasons for this addition are in paragraphs BC3.32A and BC3.32B. Do you agree with the addition of obscuring information to factors relevant to materiality judgments? If not, why not?

We support the addition of obscuring information to misstating or omitting information as factors relevant to materiality judgments because there is no public sector specific reason to deviate from IFRS. It might be worth to clarify the circumstances in which an entity judges that a material item shall not be separately displayed. For instance, one possibility would be to refer to those cases in which the information is not relevant to an understanding of the entity's financial position or financial performance (please refer to IPSAS 1 paras. 89 and 104), as situations in which a material item does not require separate presentation.

SMC 3: Rights-Based Approach to a Resource

Paragraphs 5.7A-5.7G reflect a rights-based approach to the description of resources in the context of an asset. The reasons for this approach are in paragraphs BC5.3A-BC5.3F. C Do you agree with this proposed change? If not, why not?

We agree with the proposed change because it is supportive of the notion of control and substance over form. The change could help preparers in their professional judgment in situations in which one entity has the legal ownership of the asset but there is another entity that obtains economic benefits or the service potential from the asset.

SMC 4: Definition of a Liability

The revised definition of a liability is in paragraph 5.14: A present obligation of the entity to transfer resources as a result of past events. The reasons for the revised definition *are in paragraphs BC 5.18A-5.18H. Do you agree with the revised definition? If you do not agree with the revised definition, what definition do you support and why?*

We support the revised definition of a liability.

SMC 5: Guidance on the Transfer of Resources

The IPSASB has included guidance on the transfer of resources in paragraphs 5.16A-5.16F of the section on Liabilities. The reasons for including this guidance are in paragraphs BC5.19A-BC5.19D. Do you agree with this guidance? If not, how would you modify it?

We agree with the proposed guidance, however, paragraphs 5.16D – 5.16 F could be further elaborated to include additional guidance for situations such as:

- When there is one entity that generates the obligation and there is a separate entity that actually transfers the resources (for example, when the Treasury Single Account transfers the resources on behalf of entities that not necessarily belong to the same reporting entity.)
- Settling down obligations without a transfer of resources (offsetting).
- Transactions that occur between entities of the same sub-sector or between subsectors with or without a transfer of resources.

SMC 6: Revised Structure of Guidance on Liabilities

In addition to including guidance on the transfer of resources, the IPSASB has restructured the guidance on liabilities so that it aligns better with the revised definition of a liability. This guidance is in paragraphs 5.14A-5.17D. Paragraph BC5.18H explains the reasons for this restructuring. Do you agree with this restructuring? If not, how would you modify it?

We agree with the revised structure of guidance on liabilities.

SMC 7: Unit of Account

The IPSASB has added a section of Unit of Account in paragraphs 5.26A-5.26J. The reasons for proposing this section are in paragraphs BC5.36A-BC5.36C. Do you agree *with the addition of a section on Unit of Account and its content? If not, how would you modify it and why?*

We agree with the proposed new section of Unit of Account.

SMC 8: Accounting Principles for Binding Arrangements that are Equally Unperformed

The IPSASB took the view that guidance on accounting principles for binding arrangements that are equally unperformed should be included in the Conceptual Framework, but that a separate section on accounting principles for such binding arrangements is unnecessary. These principles are included in paragraphs 5.26G-5.26H of the section on Unit of Account. The explanation is at paragraphs BC5.36DBC5.36F. Do you agree that: (a) Guidance on principles for binding arrangements that are equally unperformed is necessary; and if so (b) Such guidance should be included in the Unit of Account section, rather than in a separate section? If you do not agree, please give your reasons.

We agree with the proposed change, however we suggest including a separate section and providing a term to this type of binding arrangements. If the term of executory contracts is not appropriate, then consider adopting a different term such as "unperformed binding arrangements". A separate section for binding arrangements that are equally unperformed will help users in finding the guidance more easily.

Should you need any further information, please do not hesitate to contact us.

Sincerely,

Thomas Müller-Marqués Berger
Partner and Global Leader of Public Sector Accounting

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Annex 1:

IPSASs	Description of asymmetric prudence identified in standard
IPSAS 11.30 and 11.40	When the outcome of a construction contract can be estimated reliably, then contract revenue and contract costs associated with the construction contract shall be recognized as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date (so called percentage-of-completion-method). However, an expected deficit on a construction contract shall be recognized as an expense immediately.
IPSAS 12.15 IPSAS 12.17	The measurement of inventories at the lower of cost and net realizable value can be considered as asymmetric prudence. Whenever net realizable value is lower than cost, inventories would have to be impaired immediately. However, when net realizable value is higher than cost, no appreciation of inventories is possible. Where inventories are held for distribution at no charge or for a nominal charge or for consumption in the production process of goods to be distributed at no charge or for a nominal charge, they shall be measured at the lower of cost and current replacement cost. Also here, asymmetric prudence can be identified.
IPSAS 13.36 IPSAS 13.48	<u>Lessee</u> For a finance lease asset, the same depreciation and impairment requirements apply than for IPSAS 17 and IPSAS 31. For asymmetric prudence, please see IPSAS 17 and IPSAS 31 below. <u>Lessor</u> Lease payments receivable under a finance lease qualify as a financial asset in accordance with IPSAS 29. They are measured at amortized cost. For asymmetric prudence, please see IPSAS 29 below.

IPSAS 13.71	Sale and leaseback transactions If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount of the finance lease asset shall not be immediately recognized as revenue by a seller-lessee. Instead, it shall be deferred and amortized over the lease term. Here, a deferred recognition of the increase in value of the finance lease asset can be identified as asymmetric prudence.
IPSAS 16.65	Cost model The cost model for the subsequent measurement of investment property refers to IPSAS 17 and therefore includes impairment testing. For asymmetric prudence under the cost model, please see IPSAS 17 below.
IPSAS 17.43 IPSAS 21.68 and IPSAS 26.106 IPSAS 17.54 and 17.55	Cost model Subsequent measurement of an item of PP&E at cost including impairment qualifies as asymmetric prudence because impairment losses are recognized in surplus/deficit whereas unrealized gains are not. Under the cost model, there will be an asymmetric treatment of impairment losses and gains related to appreciation. A reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of depreciation or amortization) if no impairment loss had been recognized for the asset in prior periods. Revaluation model In addition, when applying the revaluation model, for PP&E the increase in fair value is credited to revaluation surplus. However, an increase due to a revaluation of PP&E shall be recognized in surplus or deficit to the extent that it reverses a revaluation decrease of the same class of assets previously recognized in surplus or deficit. If the carrying amount of a class of assets is decreased as a result of a revaluation, the decrease shall be recognized in surplus or deficit. A decrease shall be debited directly to

	revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that class of assets. Therefore, under the revaluation model, the fair value of an item of PP&E will be shown in the statement of financial position with a corresponding increase in net assets/equity, however, no effect in the statement of financial performance will be shown under IPSAS.
IPSAS 17.70	If the residual value of an item of PP&E increases to an amount equal to or greater than the asset's carrying amount, the asset's depreciation charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount. This requirement leads to asymmetric prudence.
IPSAS 21.68	<u>Cost model</u> Measurement at cost with impairment is asymmetric prudence because impairment losses are recognized but revaluation gains are not. For more details see IPSAS 17.
IPSAS 23.83	For transferred assets, IPSAS 12, 16, 17, 29 and 31 applies. For asymmetric prudence see the respective IPSAS.
IPSAS 26.106	<u>Cost model</u> Measurement at cost with impairment is asymmetric prudence because impairment losses are recognized but revaluation gains are not. For more details see IPSAS 17.
IPSAS 27.34	For biological assets, when fair value cannot be measured reliably, a biological asset shall be measured at its cost less any accumulated depreciation and any accumulated impairment losses. In that case, we have asymmetric prudence applying to the cost model similar to other types of fixed assets. See for example IPSAS 17.
IPSAS 29.48, 29.72 and 29.74	Measurement of loans and receivables and held-to-maturity investments at amortized cost with impairment leads to asymmetric prudence because impairment losses are recognized in surplus or deficit whereas unrealized gains are not.
IPSAS 31.73	<u>Cost model</u>

IPSAS 31.74, 31.84, 31.85	Subsequent measurement of an intangible asset at cost including impairment qualifies as asymmetric prudence because impairment losses are recognized in surplus/deficit whereas unrealized gains are not. <u>Revaluation model</u> In addition, when applying the revaluation model, for intangible assets the increase in fair value is credited directly to revaluation surplus. However, an increase due to a revaluation of intangible assets shall be recognized in surplus or deficit to the extent that it reverses a revaluation decrease of the same asset previously recognized in surplus or deficit. If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognized in surplus or deficit. A decrease shall be debited directly to revaluation surplus to the extent of any credit balance existing in the revaluation surplus in respect of that class of assets. Therefore, under the revaluation model, the fair value of an item of PP&E will be shown in the statement of financial position with a corresponding increase in net assets/equity, however, no effect in the statement of financial performance will be shown.
IPSAS 31.102	If the residual value of an intangible asset increases to an amount equal to or greater than the asset's carrying amount, the asset's amortization charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount. As in IPSAS 17, such a requirement leads to asymmetric prudence.
IPSAS 32.13	Service concession assets shall be accounted for in accordance with IPSAS 17 or IPSAS 31. Therefore, asymmetric prudence as outlined in IPSAS 17 and 31 applies.
IPSAS 41.40, IPSAS 41.61 (a), 41.73, 41.80 and 41.103	Measurement of financial assets at amortized cost with impairment leads to asymmetric prudence because impairment losses are recognized in surplus or deficit whereas unrealized gains are not.

IPSAS 43.30 et seq.	<u>Lessee</u> For a right-of-use asset, the same depreciation and impairment requirements apply than for IPSAS 16, 17 and IPSAS 31. For asymmetric prudence, please see IPSAS 16, 17 and IPSAS 31 above.
IPSAS 43.71	<u>Lessor</u> Lease payments receivable under a finance lease qualify as a financial asset in accordance with IPSAS 29 or 41 respectively. They are measured at amortized cost. For asymmetric prudence, please see IPSAS 29 or IPSAS 41 respectively above.

Source: Berit Adam, Jens Heiling and Tim Meglitsch, The Principle of Prudence in Government Accounting, in: Measurement of Assets and Liabilities in Public Sector Financial Reporting: theoretical basis and empirical evidence, edited by Josette Caruana, Marco Bisogno and Maria Francesca Sicilia (forthcoming)