

Exposure Draft 81

**Conceptual Framework Update:
Chapter 3, Qualitative Characteristics and
Chapter 5, Elements in Financial Statements**

1. Specific Matter for Comment 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?

Comment:

SIRC if ICAI observes that 'Faithful representation' rather than 'reliability' is a welcome change.

SIRC of ICAI agrees that Qualitative characteristics are relevance, faithful representation, understandable, timeliness, comparability and verifiability. At the same time, there is no distinction between fundamental and enhancing characteristics. Materiality is pervasive constraint rather than entity specific.

2. Specific Matter for Comment 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?

Comments:

There is no para:3.32B in the Exposure draft.

SIRC of ICAI supports the ambition of the ED 81 to improve the quality of the disclosures provided by preparers of financial statements and agree that it is not possible to specify a uniform quantitative threshold characteristic or a uniform set of characteristics at which a particular type of information becomes material.

At the same time, it is true financial statements frequently do not contain entity-specific and material information which would be of relevance to users and that a change in behaviour is needed. However, it is felt that the approach proposed by this ED strikes the right balance between disclosure objectives and detailed disclosure requirements. In the absence of specific disclosure requirements, it is likely to be difficult to conclude that the judgement made by the preparer is not reasonable and that specific information is needed to fulfil a certain objective. Moreover, the proposed approach may hinder achieving comparability between companies for which similar information is material and ultimately the quality of financial reporting and its usefulness for investors.

3. Specific Matter for Comment 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.

Do you agree with this proposed change? If not, why not?

The ED has deleted Para:5.7 and substitutes Paras: 5.7A to 5.7G.

Para:5.7A(a)(iii) may delete the word 'favourable'. [This is because right cannot be restricted to 'favourable' terms.]

Para:5.7C says; employee services and services-in-kind -are received and immediately consumed. This statement has a fallacy. Employees services may be used in future and also it is not necessary to consume the service immediately.

This Para further says: An entity's capability to obtain the service potential or economic benefits produced by such services exists very briefly until the entity consumes the goods and services. There are two issues on this-

i) How to measure an entity's such capability?

ii) How it can be presumed such capability will be brief? Why such capability cannot be perpetual?

Para:5.7D: What is in public domain cannot be a right of one entity and hence naturally not asset of that entity. Therefore, this part is against the legal principles and needs omission.

Para:5E: Broadly speaking, the person who creates a piece of intellectual property owns it, and has the right to possess it, sell it, or grant other persons the right to use that property. This applies to a book manuscript, a song, a photograph, a piece of art, or whatever. This has just about nothing to do with ownership of the physical object that holds the intellectual property. One may own a physical object but not IPR.

Ownership is either vested or contingent. It is vested ownership when the title of the owner is already perfect. It is contingent ownership when the title of the owner is yet imperfect but is capable of becoming perfect on the fulfilment of some condition. In the case of vested ownership, ownership is absolute. In the case of contingent ownership, it is conditional. A contingent ownership is based upon the mere possibility of future acquisition, but it is based upon the present existence of an inchoate or incomplete title Ordinarily, a right is owned by one person only at a time. However, duplicate ownership is as much possible as sole ownership. When the ownership is vested in a single person, it is called sole ownership; when it is vested in two or more persons at the same time, it is called co ownership, of which co-ownership is a species.

Therefore, this para may deal with all type of ownership and when it becomes right as an asset.

CHAPTER 5, ELEMENTS OF FINANCIAL STATEMENTS

4. Specific Matter for Comment 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 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?

Comments:

Para: 5.14 has reworded the definition of 'liability'. This definition is different from IFRS. IFRS defines a liability as "A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits."

The more appropriate definition would be 'A present obligation of the entity to transfer resources (economic or otherwise) as a result of past events.' This is because an obligation of an entity to transfer its own equity claims to another party is not an obligation to transfer an economic resource.

The Conceptual Framework is not much clear about how to identify the past event and whether a past event is sufficient to create an obligation. Questions arise if there has been some event in the past that could result in a transfer of resources (economic or otherwise) but the entity still has some ability (at least in theory) to avoid the future transfer; in other words, if the requirement to transfer an economic resource remains conditional on some future action of the entity.

The definition of a liability should encompass both constructive obligations and at least some obligations that are conditional on the entity's future actions. SIRC of ICAI favours a concept that would identify as a liability any obligation to transfer an economic resource that the entity has no practical ability to avoid. Such a concept would give the most faithful representation (or best report the substance) of the obligations that an entity cannot avoid.

The Comment section of ED says the reasons or the change in definition are contained in paras: 5.18A to 5.18H. But in the ED, there are no 5.18A to 5.18H paras.

5. Specific Matter for Comment 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?

Comments:

Paras 5.16A to 5.16F to substitute the words 'resources ('economic or otherwise') where the word 'resources' occur in line with the definition of 'Liability' suggested by us.

Para:5.16B says: 'An obligation can meet the definition of a liability even if the probability of a transfer of resources is low'. Where the probability of transfer is low, no longer it is a liability and it is a case of 'contingent liability'. Further the Para has to spell out what is the test for 'probability of transfer is low'.

Para:5.16C (ii) to substitute the words 'Obligations to provide services or deliver goods or supply goods and services' in the place of 'Obligations to provide services or deliver goods.' The Reason is: a liability may be discharged by supplying goods and service together.

This para may further add- '(f) Obligations to transfer resources if a specified uncertain future event occurs;

Para: 5.16F speaks about transfer of resource in in a situation of principal - agent relationship. An agent is an extended arm of the principal. To a third party Principal and agent are the same except where an agent acts on his own account. Therefore, if an agent has an obligation to transfer

resources to a third party. the obligation is not a liability of the Agent. Therefore, this para may be termed as an 'Explanation'.

6. Specific Matter for Comment 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?

Comments:

The legislators of many countries have limited the performance of related obligations by a public entity with the status of an operator of essential services to specific essential services which relate to the exercising of the function of an operator of that service. In activities not directly related to the essential service, the public entity is not obliged to fulfil any obligations imposed by law on the operator of essential services. It is commonly agreed that some of the regulations treat public entities as public administration authorities, at least in the functional sense, as evidenced by the indication that the obligations of public entities should be carried out within the framework of public tasks. For instance: Range of Public Entities Subject to Cyber Security Obligations. The legislators also impose independent, or autonomous, obligations on public entities. The ED may tell how such obligations as a liability to be reported and how to quantify such liabilities in monetary terms.

7. Specific Matter for Comment 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?

Comments:

SIRC of ICAI agree that the unit of account area is a challenging one. Whilst developing a generic model for unit of account determination might be difficult, we are of the view that it would be useful for the Framework either to commit to address unit of account question in each of the individual standards or to include a rebuttable presumption about the unit of account and acknowledging that there may be exceptions in individual standards that would be elaborated upon. Also the revised Conceptual Framework would benefit from guidance on how to approach a unit of account question i.e. when items should be individually analysed and when portfolio approach might be a correct one. We also note that guidance indicates that there may be different units of account justified for recognition and measurement, however the guidance does not further elaborate on such circumstances. It might be helpful to provide some further context on why this might be appropriate either through an example or additional explanation.

The Conceptual Framework should specify that the unit of account when considering recognition should be the same as when considering measurement. This does not mean that we consider the unit of account for measurement should always be the same as for recognition. However, if the

IPSASB when setting Standards were to depart from this principle, the basis for conclusions accompanying the Standard has to explain why different units of accounts were chosen.

A subsidiary, in consolidated financial statements, consists of many rights and obligations. Many of these can be subject to a separate transaction. For example, it is common practice for a group to change its structure by making, for example, a spin-off or selling a part of a subsidiary. This example would accordingly mean that an entity should not treat all its rights over a subsidiary as a single unit of account. Instead, the unit of account should be a subgroup of rights and obligations that are related to a particular activity of a subsidiary. Whereas the rights that gives control of a subsidiary would generally expire in similar patterns, the rights and obligations of a subsidiary will generally expire at different points in time. Thus, the rights and obligations of a subsidiary should not be treated as a single unit of account. Instead, the unit of account should be a subgroup of rights and obligations that are related to a particular activity of a subsidiary. It may be difficult to assess whether the different components of the subsidiary that are capable of engaging different business activities are in fact used together in the context of the business activities. It would depend on facts and circumstances. Nonetheless, different business components (e.g. core investing activities and investment-related services) may be mutually dependent and benefit from synergies between them. If so, it would suggest that an entity should treat all its rights over a subsidiary as a single unit of account.

Although the different business components may be mutually dependent and benefit from synergies between them, 'core investing activities' and 'investment related services' have different economic characteristics and risks. Thus, an entity should not treat all its rights over a subsidiary as a single unit of account (i.e. the unit of account is the combination of all the rights and obligations related to the subsidiary).

8. Specific Matter for Comment 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 BC5.36D-BC5.36F.

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.

Comments:

SIRC of ICAI agrees that the Guidance on principles for binding arrangements that are equally unperformed is necessary and such guidance should be included in the Unit of Account section, rather than in a separate section

However, this part may explain the link of IPSAS 37—JOINT ARRANGEMENTS. It may say that to refer the definition of ‘Binding arrangement’ as in IPSAS 37 ie., “a binding arrangement is an arrangement that confers enforceable rights and obligations on the parties to it as if it were in the form of a contract. It includes rights from contracts or other legal rights.”