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International Public Sector Accounting Standards Board
277 Wellington Street West
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Our response to *Exposure Draft 81: Conceptual Framework Update: Chapter 3, Qualitative Characteristics and Chapter 5, Elements in Financial Statements* is below:

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 BC3.17 A-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 agree with the revision to introduce prudence into the conceptual framework. The ED provides an appropriate definition of prudence (3.14A) and provides guidance on the application of prudence, specifically that users "*select the most relevant information that faithfully represents what it purports to represent*" (3.14B).

A positive consequence of shifting from conservativism to prudence is that it may better support natural resource accounting. Under conservativism natural resources may not have been recognized because there was insufficient certainty they were assets. However, under prudence, natural resources may be necessary to recognize: it may be argued that it is prudent for an entity to recognize natural resources, because recognition would promote sustainability and accountability for their use and protection.

Specific Matter for Comment 2: Obscuring Information as a Factor Relevant to Materiality Judgements

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 agree that obscuring information should be a consideration in making materiality judgements. This addition builds on the principle of fair presentation, as obscuring information also brings into question if the entity is following fair presentation.

Specific Matter for Comment 3: Rights-based approach to a resource

Paragraphs 5. 7 A-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?

We disagree with adding the concept of rights. Assets are a foundational element because the other elements are derived from it. In our view, adding the concept of "rights" is an inappropriate restriction on the fundamental concept. Adding "rights" risks reducing and narrowing this fundamental concept to a legalist definition, or promotes form over substance.

Instead, to support necessary new accountabilities such as natural resource accounting, IPSASB should either leave the definition of asset unchanged, or expand it.

We are concerned that "rights" is focusing on financial rights too much, possibly a consequence of importing IASB conceptual thinking into the public sector.

We disagree with 5.6A, specifically that a "resource is a right…" To demonstrate, consider cash, how is cash a "right"? It is clearly a resource, but how is it a "right"? Is the "right" the ability to spend it or exchange it? However, entities do not have control over a currency other than perhaps a sovereign government/central bank that deems the 'paper' legal currency. If cash is a "right," why can't public sector entities create their own currency?

In addition, we disagree with 5.7F. In our view, the asset is the physical building which the entity controls. The "right to use a building" is a "right," but the "right" itself does not do anything and only has value as an asset because it represents the physical building itself. A "right" cannot house people or goods, or provide shelter from elements, or produce anything itself. The "right" is an intangible at best. Although IPSASB acknowledges various rights are bundled together, such as ownership, this does not merit elevating a secondary characteristic of assets (the right) to an essential part of the definition of asset. Control is a broader and better concept than "right."

It is problematic that IPSASB is introducing "rights" because of the complexity of the concept. It may be a right to something, or a right to avoid something. There may be sovereign rights, natural rights, legal rights, individual or group rights, contractual rights ("terms"), etc. Rights may be positive (right to do something) or negative (right to be free of something). Rights shift over time for various reasons in ways that the concepts of service potential and control do not. Because rights shift and evolve, including rights could significantly reduce and impair the stability of the fundamental definition of asset, and thereby all the other elements of financial statements as well.

We also disagree with 5.7D that a right can't be recognized if everyone has it; somehow this is saying that rights that everyone has are not rights at all, which is false. In our view, this problem arises from elevating a secondary characteristic (right) to the level of the definition itself, thereby confusing it with control, and creating the need to then explain that if everyone has a right, then it can't be controlled by an entity. But the fix is to remove "right" from the definition, not add more ad-hoc concepts. Furthermore, what if everyone in one jurisdiction has a "right" but not in another?

In our view "right" is confusing or obscuring the actual resource, service potential or capacity, and is being confused with the more important concept of control. Introducing "right" as an intermediate concept to service potential is an unnecessary complication to this fundamental concept.

In our view, the above issues indicate that the "rights" approach is fundamentally flawed.

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?

We suggest a few edits to the definition. First, "events" should be "event(s)." Making "event" plural, implies that more than one single event is required for a liability to occur, but a single event may create a liability for an entity. Secondly, "for an outflow" should remain because "transfer resources" may be confused with government transfers and it is best to avoid this possible confusion, and "transfer" again reflects a more narrow (legalistic) approach to definitions that is not appropriate.

The introduction of a rights-based approach was not incorporated into the update to Liabilities. We are not suggesting it should be; we are noting this is an inconsistency which reveals the flaw of "rights" in the assets definition.

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?

The wording in paragraphs 5.16A and 5.16B is too broad. By stating "*the obligation must have the potential…*" includes too many possibilities. Many liabilities have the potential to occur, however are unlikely or very unlikely to occur. Paragraph 5.16B adds to the issue by stating "*even if the probability of a transfer of resources is low*" a liability may exist. IPSASB should better clarify what precisely is the "low" probability of transfer relating to? Is it any of the three liability criteria in 5.14A: either it is uncertain whether the entity actually has an obligation, and (or) it is uncertain if the obligation is to transfer resources, and (or) it is uncertain whether one or more past events have occurred, not just criteria 2. Based on this wording, is the uncertainty relating mainly to the outflow of resources? Does the IPSAB expect public sector entities to record liabilities for future potential floods, potential earthquakes, or potential accidents, such as an accident at a power plant or water dam? Such occurrences can have low/extremely low probability but would have a significant impact if and when they occur, and a past event (say the construction of a building that may be damaged) has occurred. Many may not agree with such an approach to accounting.

Furthermore, we are concerned that without additional guidance or revisions to the current wording, financial statements may inadvertently obscure information and the conceptual framework would inadvertently create "levels" of liabilities, such as "known liabilities" (AP, vacation pay, long-term debt, etc.) and "potential liabilities" (potential natural disaster liability, etc.).

For the above reasons, we think "A transfer of Resources from the Entity" section needs to be revised to constrain what constitutes a liability.

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?

Yes – we agree with the restructuring.

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?

As noted above, we have concerns with the introduction of "rights" by the ED. The section on Unit of Account incorporates "rights" and we recommend this be removed here as well. For example, paragraph 5.26A should be edited as follows: "*The unit of account is <u>the service potential or capability to generate economic benefits</u>, or ~~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*." Similar edits should be made throughout the section.

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?

As noted above, we have concerns with the introduction of "rights" by the ED. If paragraphs 5.26G-5.26H are edited and "rights" are removed, the guidance will strictly cover binding arrangements over obligations, and these are currently covered in other IPSAS standards, such as IPSAS 19 – Provisions, Contingent Liabilities and Contingent Assets, therefore we do not agree that additional guidance is required.

Thank you for the opportunity to comment.

Sincerely,

Colin Semotiuk
Wayne Morgan