Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities - IPSAS

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From PSC Studies to Conceptual Framework

‚Conceptual‘ issues of Public Sector Committee and IPSAS Board:

- PSC Studies (1991-1996)
- IPSAS 1 (2000)
- Consultation Papers (2008-2012)
- Exposure Drafts (2010-2013)
- Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (2013)

Structure of Conceptual Framework

- Preface
- Role and Authority of Conceptual Framework
- Objectives and Users of General Purpose Financial Reporting
- Qualitative Characteristics
- Reporting Entity
- Elements of Financial Statements
- Recognition in Financial Statements
- Measurement of Assets and Liabilities
- Presentation in General Purpose Financial Reports

Role of Conceptual Framework

- ‚The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* establishes the concepts that underpin general purpose financial reporting by public sector entities that adopt the accrual basis of accounting.
- The International Public Sector Accounting Standards Board (IPSASB) applies these concepts in developing International Public Sector Accounting Standards (IPSASs) and Recommended Practice Guidelines (RPGs) applicable to the preparation and presentation of general purpose financial reports (GPFRs) of public sector entities.‘

Authority of Conceptual Framework (CF)

- The CF does not establish authoritative requirements for financial reporting by public sector entities that adopt IPSASs,
- The CF does not it override the requirements of IPSASs or RPGs.
- Authoritative requirements relating to the recognition, measurement and presentation of transactions and other events and activities that are reported in GPFRs are specified in IPSASs.

General Purpose Financial Reports

- GPFRs are financial reports intended to meet the information needs of users who are unable to require the preparation of financial reports tailored to meet their specific information needs.
- GPFRs encompass financial statements (incl. notes) and the presentation of information that enhances, complements and supplements the financial statements.

vs.

- Special Purpose Financial Reports - prepared to respond to the requirements of users that have the authority to require the preparation of financial reports that disclose the information they need for their particular purposes.

Objectives of General Purpose Financial Reporting

…to provide information about the entity that is useful to users of GPFRs for

- **ACCOUNTABILITY** purposes

and for

- **DECISION-MAKING** purposes.

Users of General Purpose Financial Reports

Primary users:

- Service recipients
- Resource providers
- Legislature (or similar body) and members of parliament (or similar representative body) - representatives of the interests of service recipients and resource providers

Users of GPFRs

Other parties:

- Government statisticians, analysts, media, advisors, public interest groups etc…

Organizations that have authority to require the preparation of financial reports **TAILORED to meet their own specific information needs are not primary users** regardless these organizations use the information provided by GPFRs for their own purposes (regulatory and oversight bodies, **audit institutions**, entity management, rating agencies etc…)

Information Provided by GPFRs

- **Financial position, financial performance, cash flows** – presented in **financial statements**;
- GPFRs may also provide financial or non-financial **information that enhances, complements and supplements the financial statements** (either as **notes to financial statements** or in **separate reports** included in GPFRs):

  - **compliance with approved budget** and other authority governing operations of the entity,

  - **service delivery activities** and achievements during the reporting period, and

  - **expectation** regarding service delivery and other activities in **future periods**, and the long term consequences of decisions made and activities undertaken during the reporting period.
- **Information presented in financial statements remains at the core of financial reporting!!!**

Qualitative Characteristics

- **Relevance** - financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of financial reporting.
- **Faithful representation** – information must be a faithful representation of the economic and other phenomena. Faithful representation is attained when the depiction of the phenomenon is complete, neutral *(the absence of bias)*, and free from material error.
- **Understandability** - the quality of information that enables users to comprehend its meaning.
- **Timeliness** - having information available for users before it loses its capacity to be useful for accountability and decision-making purposes.

Qualitative Characteristics

- **Comparability** - the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena.
- **Verifiability** - the quality of information that helps assure users that information in GPFRs faithfully represents the economic and other phenomena that it purports to represent.

Consatrains on Information Included in GPFRs

- **Materiality** - information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs prepared for that reporting period.
- **Cost-benefit** - application of the cost-benefit constraint involves assessing whether the benefits of reporting information are likely to justify the costs incurred to provide and use the information.
- **Balance between the qualitative characteristics** - a balancing or trade-off between qualitative characteristics may be necessary to achieve the objectives of financial reporting.

Reporting Entity

- **Public sector reporting entity** – a government or other public sector organization, program or identifiable area of activity that prepares GPFRs.
- Public sector reporting entity may comprise two or more separate entities that present GPFRs as if they are a single entity (**group reporting entity**).

Key characteristics of a RE:

- It is an entity that raises resources from, or on behalf of, constituents and/or uses resources to undertake activities for the benefit of, or on behalf of, those constituents; and
- There are service recipients or resource providers dependent on GPFRs of the entity for information for accountability or decision-making purposes.

Defined Elements of Financial Statements

- Broad classes of financial effects of transactions and other events which share common economic characteristics.
- Initial point for:

  - recording,
  - classifying and
  - aggregating.
- „Elements“ vs. „Other phenomena“

Elements of Financial Statements

- **Asset**
- **Liability**
- **Revenue**
- **Expense**
- **Ownership contributions**
- **Ownership distributions**

- **Other economic phenomena (other resources, other obligations) ARE NOT elements of FS!!!**

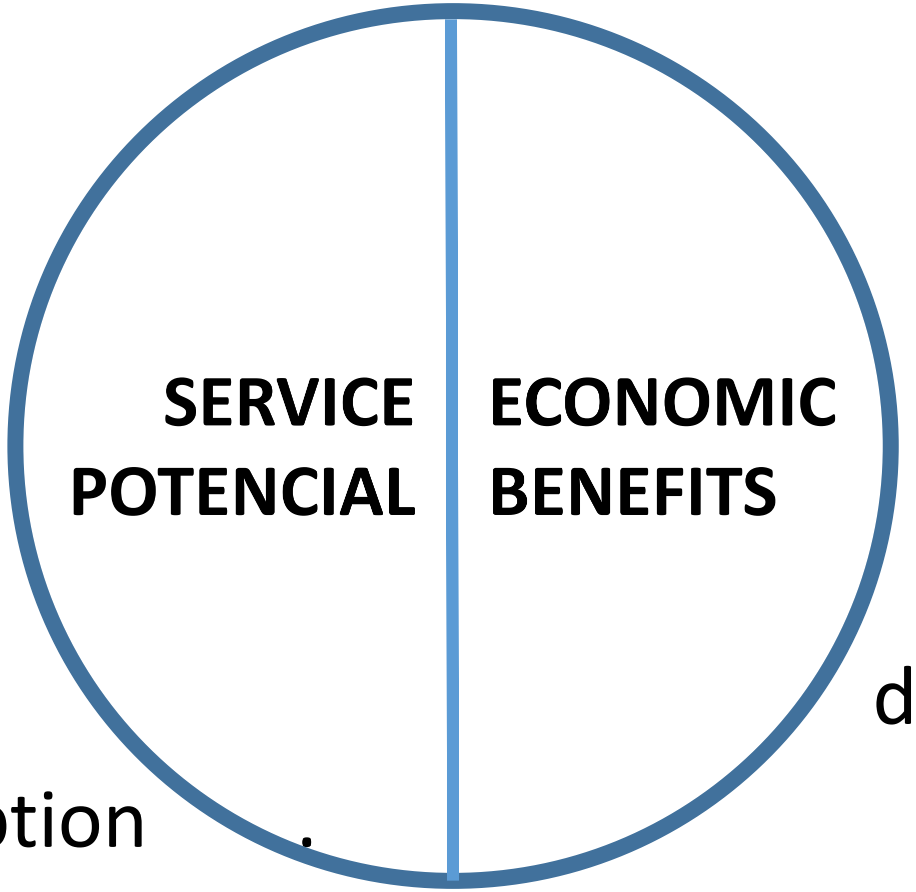
Asset

A resource presently controlled by the entity as a result of a past event.

- **Resource** - item with **service potential** or the ability to generate **economic benefits.**
- **Service potential** - the capacity to provide services that contribute to achieving the entity’s objectives. (Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows.)
- **Economic benefits** - cash inflows or a reduction in cash outflows.

Benefits

Recreational, heritage, community, defense, etc… assets for collective or individual consumption.



An asset used for production and sale of goods and services, an asset directly exchanged for cash etc…

Liability

A present obligation (to an external party) of the entity for an outflow of resources that results from a past event

- **Present obligation** - a legally binding obligation (enforceable in law) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid (an outflow of resources).
- **Non-legally binding obligation:**

a) ***Subjective attribute:*** 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;

b) ***Objective attribute:*** 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

c) ***Other attribute:*** The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

Other Economic Phenomena

- 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 Conceptual Framework may be necessary.

- **Other resources**
- **Other obligations**

Net Financial Position vs. Net Assets/Equity

- Net financial position (NFP) 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.
- NFP can be positive or negative residual amount.

(1) NAE = Assets – Liabilities

(2) NFP = Assets + Other resources – (Liabilities + Other obligations)

<table>
<tr><th>ASSETS and Other Resources</th><th></th><th>LIABILITIES and Other Obligations + NET FINANCIAL POSITION</th></tr>
<tr><td rowspan="3">ASSETS</td><td></td><td>LIABILITIES</td></tr>
<tr><td rowspan="2">NET ASSETS/ EQUITY</td><td>OTHER OBLIGATIONS</td></tr>
<tr><td rowspan="2">NET FINANCIAL POSITION</td></tr>
<tr><td>OTHER RESOURCES</td><td></td></tr>
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Exposure Draft CF – Deferred Flows Concept (digression☺)

- *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.*
- *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.*

Revenue and Expense

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

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

- **SURPLUS OR DEFICIT FOR THE PERIOD** - the difference between revenue and expense reported on the statement of financial performance.

Ownership Contribution and Ownership Distribution

- **OWNERSHIP CONSTRIBUTIONS - 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.**
- **OWNERSHIP DISTRIBUTIONS - 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.**
- *Not only investments and dividends…*

Recognition and Derecognition in Financial Statements

Recognition criteria:

- An item satisfies the definition of an element; and
- Can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs.

ALL items that satisfy both criteria are recognized in the financial statements!!!

Other resources or other obligations (regardless does not meet the definition of an element) can be recognized according an IPSAS.

Derecognition is the process of evaluating whether changes have occurred since the previous reporting date that require removing an element that has been previously recognized from the financial statements, and removing the item if such changes have occurred.

Measurement of Assets and Liabilities in Financial Statements

Objective:

- Selection of those measurement basis that most fairly reflect
  - a) cost of services provided in current period,
  - b) operational capacity (capacity to operate in future through physical and other resources),
  - c) financial capacity (funding of activities)

and

- Evaluation of the extent the information achieves the qualitative characteristic (taking into account the constraints)

Summary of Measurement Basis for Assets (CF 7.6)

Measurement Basis	Entry or Exit	Observable or Unobservable in a Market	Entity or Non-entity Specific
Historical cost	Entry	Generally observable	Entity-specific
Market value in open, active and orderly market	Entry and exit	Observable	Non-entity-specific
Market value in inactive market	Exit	Dependent on valuation technique	Dependent on valuation technique
Replacement cost	Entry	Observable	Entity-specific
Net selling price	Exit	Observable	Entity-specific
Value in use	Exit	Unobservable	Entity-specific

Historical Cost

The consideration given to acquire or develop an asset, which is the cash or cash equivalents or the value of the other consideration given, at the time of its acquisition or development.

- The measurement of an asset is not changed to reflect changes in prices or increases in the value of the asset.
- Depreciation and amortization, impairment, increase of asset (cost of additions and enhancements, accrual of interest on financial asset).

Market Value

The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

- Market values in open, active and orderly market vs. market values where it cannot be assumed that markets are open, active and orderly.

Replacement Cost (RC)

The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.

- RC reflects the replacement of service potential in the normal course of operations.

Replacement cost vs. Reproduction cost:

- Replacement cost is the cost of replacing an asset‘s service potential vs. Reproduction cost is the cost of acquiring an identical asset.
- RC is based on an alternative asset if this alternative would provide the same service potential more cheaply.
- RC of an asset reflect reductions in required service capacity.

Net Selling Price

The amount that the entity can obtain from sale of the asset, after deducting the costs of sale.

- An asset cannot be worth less to the entity than the amount it could obtain on sale of the asset.
- Net selling price is useful where the most efficient course available to the entity is to sell the asset.

Value in Use

The present value to the entity of the asset's remaining service potential or ability to generate economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life.

- The value that will be derived from an asset is often greater than its replacement cost—it is also usually greater than its historical cost. Where this is the case, reporting an asset at its value in use is of limited usefulness, as by definition, the entity is able to secure equivalent service potential at replacement cost.
- Value in use is also not an appropriate measurement basis when net selling price is greater than value in use, as in this case the most resource-efficient use of the asset is to sell it, rather than continue to use it.
- Value in use is appropriate where it is less than replacement cost and greater than net selling price.

Summary of Measurement Basis for Liabilities (CF 7.7)

Measurement Basis	Entry or Exit	Observable or Unobservable in a Market	Entity or Non-entity Specific
Historical cost	Entry	Generally observable	Entity-specific
Cost of fulfillment	Exit	Unobservable	Entity-specific
Market value in open, active and orderly market	Entry and exit	Observable	Non-entity specific
Market value in inactive market	Exit	Dependent on valuation technique	Dependent on valuation technique
Cost of release	Exit	Observable	Entity-specific
Assumption price	Entry	Observable	Entity-specific

Historical Cost (for a liability)

The consideration received to assume an obligation, which is the cash or cash equivalents, or the value of the other consideration received at the time the liability is incurred.

- Initial measures may be adjusted: accruals of interest, accretion of discount or amortization of a premium.

Cost of Fulfillment

The costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner.

- If fulfillment requires work to be done the relevant costs are those that the entity will incur.
- If fulfillment will not take place for an extended period, the cash flows need to be discounted.

Market value (for liabilities)

The amount for which a liability could be settled between knowledgeable, willing parties in an arm's length transaction.

- The advantages and disadvantages of market value for liabilities are the same as those for assets.
- May be appropriate, e.g. where the liability is attributable to changes in a specified rate, price or index quoted in an open, active and orderly market.

Cost of Release

Cost of release refers to the amount of an immediate exit from the obligation.

- Analogous concept to net selling price for asset.
- Cost of release is the amount that either the creditor will accept in settlement of its claim, or a third party would charge to accept the transfer of the liability from the obligor.
- If cost of fulfillment is lower than cost of release, cost of fulfillment provides more relevant information than cost of release.

Assumption Price

The amount which the entity would rationally be willing to accept in exchange for assuming an existing liability.

- Analogous concept to replacement cost for asset.
- An entity would assume a liability only if the amount it is paid to assume the liability is greater than the cost of fulfillment or release.

Fair Value as Measurement Basis?

- According Conceptual Framework IPSAS the fair value is not measurement basis.
- Fair value is represented by one of measurement basis mentioned in Conceptual Framework in particular context (e. g. market value).
- Fair value is used by specific IPSASs.

Presentation in GPFRs

Information selection:
- In the financial statements
- In GPFRs outside the financial statements
- Displayed or disclosed information

Information location:
- Which report
- Which component of report

Information organization:
- How information is arranged within a GPFR
- The overall structure of GPFR

Thank you for your attention