

Swiss Comments to the Consultation Paper

Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Elements and Recognition in Financial Statements Phase 2: Consultation Paper

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1. Introduction

During its meeting on May 23, 2011, the Swiss Public Sector Financial Reporting Advisory Committee agreed upon the following statement for the attention of the IPSAS Board. The Swiss Public Sector Financial Reporting Advisory Committee (SRS-CSPSP) was established in 2008 by the Swiss Federal Ministry of Finance together with the Ministers of Finance at the cantonal level. One of its aims is to provide the IPSAS Board with a consolidated statement for all the three Swiss levels of government (municipalities, cantons and Confederation).

2. Fundamental Comments on the Consultation Paper

The textual content of the *Consultation Paper* is felt to be very difficult to understand. In many cases the questions are not clear, which makes it very difficult to answer them.

As this *Consultation Paper* is an element of the *Conceptual Framework*, it is understandable that the content is of a fairly theoretical nature. However the manner, in which the text was written, is far too abstract. Therefore a more comprehensible version should again be circulated for comment, at the latest in the form of the *Exposure Draft*.

3. Detailed Comments on the Specific Matters for Comment

3.1 Specific Matter for Comment 1

3.1.1 (a) Should the definition of an asset cover all of the following types of benefits – those in the form of:

- (i) Service potential;
- (ii) Net cash inflows; and
- (iii) Unconditional rights to receive resources?

Yes. But the question remains unanswered whether the definition is complete in respect of the capitalisation of Capital grants (Capital grants are monetary benefits, with which for the recipient of the grants long-term assets with investment character are constituted).

It would be desirable, if the expression „*unconditional rights*“ could be further specified.

3.1.2 (b) What term should be used in the definition of an asset:

- (i) Economic benefits and service potential; or
- (ii) Economic benefits?

Both expressions – „*Economic benefits*“, and „*Service potential*“ – should be used.

3.2 Specific Matter for Comment 2

3.2.1 (a) Which approach do you believe should be used to associate an asset with a specific entity:

- (i) Control;
- (ii) Risks and rewards; or
- (iii) Access to rights, including the right to restrict or deny others' access to rights?

It should be possible to use all the approaches. They should then be defined according to the situation in the relevant IPSAS. Even if it seems obvious, it is pointed out that the approaches are in any event not to be used cumulatively.

3.2.2 (b) Does an entity's enforceable claim to benefits or ability to deny, restrict, or otherwise regulate others' access link a resource to a specific entity?

Yes, e.g. for the special case of the investment grants given (see also Heading 3.1.1).

3.2.3 (c) Are there additional requirements necessary to establish a link between the entity and an asset?

No, no additional requirements are apparent.

3.3 Specific Matter for Comment 3

Is it sufficient to state that an asset is a "present" resource, or must there be a past event that occurs?

The use of the expression „*Past event*“ is regarded as a useful supplement to delimit a case better from future events.

In this connection it is pointed out that it seems somewhat of a simplification to define an „*asset*“ as a resource. In particular by reference to the economic sense of the expression, as is discussed in the *Consultation Paper* under Heading 2.12 ff. By resource in the economic sense is understood the production factors *labour, capital and land*. If an „*asset*“ is defined on this basis, liquid funds and financial investments are excluded. In fact liquid funds and financial investments are only the financial tools to acquire a resource. They are therefore not resources in the economic sense.

3.4 Specific Matter for Comment 4

Recognition and measurement criteria aside, are public sector entity rights and powers, such as those associated with the power to tax and levy fees, inherent assets of a public sector entity, are they assets only when those powers are exercised, or is there an intermediate event that is more appropriate?

In the public sector the criterion as an asset is fulfilled as soon as "*powers are exercised*". In the illustration on Page 27 of the *Consultation Paper* this corresponds with the step "*Tax is assessed or application approved*". In our view there is no upstream "*intermediate event*".

3.5 Specific Matter for Comment 5

3.5.1 (a) Are there any additional characteristics that have not been identified that you believe are essential to the development of an asset definition?

No, no additional characteristics are apparent.

3.5.2 (b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of assets?

Yes. A first relevant topic concerns the difference between *Administrative Assets* and *Non Administrative Assets*, which is relevant for the public sector: *Administrative Assets* are defined as all assets that are earmarked for the fulfilment of public-sector duties. *Administrative Assets* are thus characterized by a permanent dedication to a purpose established by the public sector. *Administrative Assets* are all those assets that relate to the provision of public services and that have a useful life extending over several fiscal years. In contrast, assets can be considered realizable (*Non Administrative Assets*) if they can be liquidated without violating specific legal (public-law) obligations.

For 30 years the difference between *Administrative Assets* and *Non Administrative Assets* has been used successfully in Switzerland in more than 3,000 corporations. And other European countries are also familiar with this difference.

It is important in particular in measuring assets: *Administrative assets* are valued using „*Historical cost*“, *Non Administrative Assets* using „*Market value*“. Furthermore the difference is important also for investors. It can be seen which assets cannot be realized to meet obligations. *Administrative Assets* – in contrast to *Non Administrative Assets* – can as a rule not be pledged.

Here again a second topic concerns the capitalizability of Capital grants (see also Heading 3.1.1).

3.6 Specific Matter for Comment 6

3.6.1 (a) Should the definition of a liability cover all of the following types of obligations?

- (i) Obligations to transfer benefits, defined as cash and other assets, and the provision of goods and services in the future.

Yes.

- (ii) Unconditional obligations, including unconditional obligations to stand ready to insure against loss (risk protection).

No, because the wording is contingent liabilities. If however the question were supplemented with „past event“, the answer would be Yes.

- (iii) Performance obligations.

Yes.

- (iv) Obligations to provide access to or forego future resources.

No. The considerations in connection with rents seem to go far too far.

3.6.2 (b) Is the requirement for a settlement date an essential characteristic of a liability?

No.

3.7 Specific Matter for Comment 7

3.7.1 (a) Should the ability to identify a specific party(ies) outside the reporting entity to whom the entity is obligated be considered an essential characteristic in defining a liability, or be part of the supplementary discussion?

No, no "essential characteristic". Example: Provision for coins in circulation in Federation.

3.7.2 (b) Do you agree that the absence of a realistic alternative to avoid the obligation is an essential characteristic of a liability?

Yes.

3.7.3 (c) Which of the three approaches identified in paragraph 3.28 do you support in determining whether an entity has or has not a realistic alternative to avoid the obligation?

Approach c). Whereby there is wide scope for interpretation. The approach would therefore have to be specifically defined.

3.8 Specific Matter for Comment 8

Is it sufficient to state that a liability is a "present" obligation, or must there be a past event that occurs?

A "past event" is needed, in order that there is as much clarity as possible in this question.

3.9 Specific Matter for Comment 9

3.9.1 (a) Recognition and measurement criteria aside, are public sector entity obligations such as those associated with its duties and responsibilities as a government, perpetual obligations, obligations only when they are enforceable claims, or is there an appropriate intermediate event that is more appropriate?

Yes. "*Services rendered or goods received*" and "*Program conditions met by recipients*" in the illustration on Page 39 of the *Consultation Paper* are understood as "*past events*". In connection with the assets it seems important that both expressions "*past event*" and "*intermediate event*" are clearly defined.

It seems to us that the expressions "*past event*" and "*intermediate event*" are mixed when it comes to liabilities. But we can appreciate the intention of the IPSAS Board and the necessity of maintaining a symmetry with the assets (see Heading 3.4). But this also demonstrates the need for the IPSAS Board to better indicate the difference in the two expressions "*past event*" and "*intermediate event*". That means that the expression "*intermediate event*" should be clearly defined.

3.9.2 (b) Is the enforceability of an obligation an essential characteristic of a liability?

Yes.

3.9.3 (c) Should the definition of a liability include an assumption about the role that sovereign power plays, such as by reference to the legal position at the reporting date?

Yes, regarded as sensible. The *Conceptual Framework* could then provide information as to how various cases are to be treated.

3.10 Specific Matter for Comment 10

3.10.1 (a) Are there any additional characteristics that have not been identified that you believe are essential to the development of a liability definition?

Yes, here the question is raised in respect of investment grants being carried as liabilities (analogous question for the *assets*).

3.10.2 (b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of liabilities?

No, no other issues are apparent.

3.11 Specific Matter for Comment 11

3.11.1 (a) Should revenues and expenses be determined by identifying which inflows and outflows are "applicable to" the current period (derived from a revenue and expense-led-approach), or by changes in net assets, defined as resources and obligations, "during" the current period (derived from an asset and liability-led-approach)?

The "*Revenue and expense-led approach*" is preferable. In the public sector the Statement of Financial Performance (income statement) is clearly more important than the Statement of Financial Position (balance sheet), in particular also in connection with the Financial Bill (Budget represents an expenditure approval). Therefore a divergence here from IFRS seems absolutely justified.

The balance sheet is an important instrument for the investors. For all other classes of „users“ of GPFSS (such as governments, parliaments, auditing bodies and taxpayers) the information provided by the income statement is more important (budget approval and observance of the budget entitlements, information about the costs of services provided for the people, information about the coverage of the costs by revenue, in particular taxes, etc.). For most political decisions in the public sector the balance sheet plays a less important role, rather it is a question of weighing up the costs and benefits.

Nonetheless the role of the balance sheet must not be neglected, because it is also important for assessing revenue and expenditure and indebtedness.

3.11.2 (b) What arguments do you consider most important in coming to your decision on the preferred approach?

Recording must comply with the principles of Accrual Accounting and „Matching costs and revenues“. We suggest taking up the „Matching costs and revenues“ principles in the Accounting Principles of IPSAS.

It is also very important for the correct recording of the financial flows to consider the purpose of the assets: if the purpose of an asset is to re-sell it, it is to be recognized at market value. On the other hand assets serving the fulfilment of public sector duties are to

be recognized in the balance sheet at historical cost (see also Heading 3.5.2 Difference between Finance Assets and Administrative Assets).

3.12 Specific Matter for Comment 12

3.12.1 (a) Should transactions with residual/equity interests be excluded from revenues and expenses?

Yes, e.g. allocations to reserves or for the use of funds in equity.

3.12.2 (b) Should the definitions of revenue and expense be limited to specific types of activities associated with operations, however described?

No. Exceptions should however be possible in cases of potential valuation corrections, such as on shares (unrealized).

Therefore the *Conceptual Framework* should allow certain asset movements to be recorded directly in equity and not over the income statement. The specific exceptions would then have to be governed in the relevant IPSAS.

3.13 Specific Matter for Comment 13

3.13.1 (a) Are there any additional characteristics that have not been identified that you believe are essential to the development of definitions of revenues and expenses?

No, no additional characteristics are apparent.

3.13.2 (b) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the definitions of revenues and expenses?

No, no additional issues are apparent.

3.14 Specific Matter for Comment 14

3.14.1 (a) Do deferrals need to be identified on the statement of financial position in some way?

No. The Accrual Accounting principle is to be considered. But not in the sense of the expression „deferral“ per US GASB (*Governmental Accounting Standards Board*).

3.14.2 (b) If yes, which approach do you consider the most appropriate? Deferred outflows and deferred inflows should be:

- (i) Defined as separate elements;
- (ii) Included as sub-components of assets and liabilities, or
- (iii) Included as sub-components of net assets/net liabilities.

Because the answer to (a) is No, no answer is possible here.

3.14.3 (c) If defined as separate elements, are the definitions of a deferred outflow and deferred inflow as set out in paragraph 5.8 appropriate and complete?

Because the answer to (a) is No, no answer is possible here.

3.15 Specific Matter for Comment 15

3.15.1 (a) Do you consider net assets/net liabilities to be a residual amount, a residual interest, or an ownership interest?

A distinction must be made here between two types of reporting entity: for territorial jurisdictions (Federation, cantons, communities) the answer is „*residual interest*“. For independent entities the answer is „*ownership interest*“.

3.15.2 (b) Should the concept of ownership interests, such as those that relate to minority or non-controlling interests in a GBE, be incorporated in the element definition?

Yes.

3.15.3 (c) Are there other relevant issues, and particularly unique public sector considerations, that the IPSASB needs to consider in determining the concept of net assets/net liabilities?

Yes. Special cases still have to be governed. For example special financing and funds in equity or valuation corrections on shares.

By special financing is meant the complete or partial earmarking of revenues for specific tasks. As a rule income or general government revenues without a causal connection with their usage are earmarked by law in funds in equity.

3.16 Specific Matter for Comment 16

3.16.1 (a) Should transactions with residual/equity interests be defined as separate elements?

Yes. They should be disclosed in the movement on equity.

3.16.2 (b) If defined as separate elements, what characteristics would you consider essential to their definition?

For example, the caption that is concerned within equity and clear criteria as to when recording within equity is permitted and when not.

3.17 Specific Matter for Comment 17

3.17.1 (a) Should recognition criteria address evidence uncertainty by requiring evidence thresholds; or by requiring a neutral judgment whether an element exists at the reporting date based on an assessment of all available evidence; or by basing the approach on the measurement attribute?

No criterion is preferred.

3.17.2 (b) If you support the threshold approach or its use in a situational approach, do you agree that there should be a uniform threshold for both assets and liabilities? If so, what should it be? If not, what threshold is reasonable for asset recognition and for liability recognition?

Because under (a) no criterion is preferred, an answer is not possible here.

3.18 Specific Matter for Comment 18

Do you support the use of the same criteria for derecognition as for initial recognition?

Yes, in principle the same criteria should be applied. Exceptions are to be provided in the specific IPSAS.

3.19 Specific Matter for Comment 19

Should the recognition criteria be an integral part of the element definitions, or separate and distinct requirements?

It should be an „*integral part*“, because the advantages for the user predominate.

Lausanne, June 7, 2011