Chapter 7 — Elements of ~~F~~financial ~~S~~statements

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BACKGROUND

7.01 PSAB ~~has~~ confirms~~ed~~ that only economic phenomena ~~should~~ are~~be~~ reported on the financial statements of an entity. Economic phenomena take the form of economic resources and economic obligations and changes in them.

~~7.01~~7.02 The elements of financial statements are defined in terms of economic phenomena. The~~se~~ ~~include~~elements are:

(a) assets;

(b) liabilities;

(c) revenues; and

(d) expenses.

~~These are the elements of financial statements.~~ Deferred inflows and deferred outflows are not elements in the ~~proposed~~ revised conceptual framework.

~~7.02~~7.03 PSAB also confirms~~ed~~ that net assets or ~~/~~net liabilities is a residual amount, not an element.

~~7.03~~7.04 ~~The review of these elements has also led~~ PSAB proposes some ~~to~~ improvements to the revenue and expense definitions ~~of the elements~~, including making them singular and adopting a parallel structure. The proposed revenue definition ~~has been improved to~~ requires that the changes in assets and liabilities result in an increase in net assets or decrease in net liabilities. Similarly, the proposed expense definition ~~has been improved to~~ requires that the changes in assets and liabilities result in a decrease in net assets or an increase in net liabilities. Previously, this effect was only recognized in the guidance accompanying the revenue and expense definitions.

~~7.04~~7.05 Appendix X provides the rationale for these decisions.

~~7.05~~7.06 Exceptions to the elements (~~i.e.~~for example, the existence of deferrals) exist within the current PSA Handbook. These exceptions have arisen over time. The exceptions were developed for pragmatic reasons reflecting the stage of the evolution of practice in the ~~public sector~~ community. Some exceptions were created before a formal conceptual framework was in place. Exceptions arising after approval of the existing conceptual framework would have been debated and approved by PSAB, but not necessarily documented. It is expected that future exceptions to the conceptual framework will be rare, and when they are allowed, they will be substantively justified at the standards level. Documentation of the reasons will be required.

~~7.06~~7.07 The definitions of financial assets, non-financial assets and tangible capital assets are proposed to be relocated to ~~Section PS 1202,~~ FINANCIAL STATEMENT PRESENTATION, Section PS 1202, ~~the~~ a proposed new financial statement presentation standard. These are categories of assets and not elements of financial statements.

INTRODUCTION

7.08 The users of ~~public sector~~ financial statements are interested in economic phenomena because~~.~~ ~~E~~economic phenomena ~~are those actual items, transactions and other events that~~ make up the financial performance and financial position of an ~~public sector~~ entity.

~~7.07~~7.09 Phenomena are observable facts, circumstances or events. Economic phenomena are events that involve the production or other creation, accumulation, consumption, distribution and allocation of value or wealth, including resources, goods, services, and commodities. For the purposes of financial statements, economic phenomena of an entity are its economic resources, its economic obligations and the effects of events that change those economic resources and economic obligations. Economic phenomena ~~The broader term "economic" is contrasted with the narrower term "financial", which focuses primarily on monetary transactions, events and other changes. "Economic" is intended to~~ encompass both financial and non-financial (or, alternatively, both monetary and non-monetary) resources, obligations, transactions and other events, including both tangible and intangible items. Transactions within the same reporting entity are not considered economic phenomena for purposes of the financial statements of that entity. They are allocations within the same economic entity rather than the creation or consumption of something with economic substance.

Commented [AR1]: Added to define phenomena and economic phenomena as discussed at the last Task Force meeting.

Commented [AR2]: Removed as the term "economic" is defined along with the definition of "economic phenomena".

~~7.08~~7.01 ~~The purpose of identifying elements of financial statements is to provide a common and useful starting point for classifying items, transactions and other events in a way that will enhance users' understanding of the detailed information contained in an entity's financial reporting system.~~

Commented [AR3]: Paragraph moved below to help with the flow of the discussion.

~~7.09~~7.10 Financial statements are representations of the results of numerous transactions and other events that necessarily involve a high degree of summarization and classification. The ability of users to understand large numbers of items, transactions and other events is enhanced when information is aggregated into common classification types that characterize their nature.

7.11 The purpose of identifying elements of financial statements is to provide a common and useful starting point for classifying items, transactions and other events in a way that will enhance users' understanding of the detailed information contained in an entity's financial reporting system.

~~7.10~~7.12 Elements are important because they represent the first level of grouping similar items together for the purposes of making that summarization and classification. Elements of financial statements are not~~, however,~~ just groupings of items based on shared nature or common distinguishable characteristics. Elements of financial statements are the basic categories of items portrayed therein in order to satisfy the foundational concepts and meet the objectives of financial statements. The elements of financial statements are designed to provide information needed for measuring financial performance and financial position.

~~7.11~~7.13 Element definitions are driven by the foundations of financial statements, described in Chapter 5, such as the boundary of the reporting entity, the accrual basis of accounting and ~~how~~ the service capacity ~~is measured~~concept.

~~7.12~~7.14 Financial statements are prepared to report on the finances of an identifiable economic reporting entity, including its subsidiary components and organizations. The boundary of the economic entity is ~~determined~~ defined by what it controls~~; that is~~~~, (i.e., the economic resources and financial affairs that the public sector entity controls)~~.

~~7.13~~7.15 Under ~~a cash basis of accounting, for example, elements would be only cash and near cash items and flows of cash. In contrast, under~~ the accrual basis of accounting, element definitions must encompass all of the economic resources that an ~~public sector~~ entity controls, the economic

Commented [AR4]: It was suggested at the last TF meeting that maybe the discussion of the cash basis of accounting was not required.

obligations it must meet and the increases or decreases in those resources and obligations, regardless of when cash is exchanged.

~~7.14~~7.16 For financial statement purposes, service capacity is considered to comprise economic resources that have the ability to discharge financial claims or finance future service provision, and those that will be applied directly in service provision, less any claims on those resources. ~~Thus~~ ~~e~~Element definitions need to reference economic resources, economic obligations and changes in them in order for the financial statements to provide a measure of the ability of the entity to serve the public.

~~7.15~~7.17 There are two types of elements:

(a) those that describe economic resources and economic obligations of an ~~public sector~~ entity at a point in time; and

(b) those that describe changes in economic resources and economic obligations over a period of time.

For the purposes of financial statements, the elements are described as~~:~~ assets, liabilities, revenues and expenses.

~~7.16~~7.18 The elements that describe the economic resources and economic obligations of an ~~public sector~~ entity at a point in time are assets and liabilities. The elements that comprise the change in net economic resources in an accounting period are revenues and expenses. Their definitions are derived from the definitions of assets and liabilities. This approach instills rigour and discipline, promotes consistency and improves comparability in the determination of financial performance.

~~7.17 Notes to financial statements are not considered to be an element as they do not affect the measures of financial performance and financial position.~~

Commented [AR5]: Removed as it seemed out of place.

~~ELEMENT DEFINITIONS~~ASSETS

~~Assets and Liabilities~~Definition

7.19 An **asset** is a present economic resource controlled by an entity as a result of past events and from which future economic benefits are expected to be obtained.

Characteristics

~~7.18~~7.20 Assets have three essential characteristics:

(a) they embody future economic benefits that involve a capacity, singly or in combination with other assets, to provide goods and services, to provide future cash inflows, or to reduce future cash outflows;

(b) the ~~public sector~~ entity can control the economic resource and access to the future economic benefits; and

(c) the event giving rise to the ~~public sector~~ entity's control has already occurred.

~~7.19 Economic resources comprise scarce commodities that can be used actively for consumption, production, exchange or passively for providing economically quantifiable benefits to a jurisdiction and its population.~~

Commented [AR6]: Removed based on the TF discussion at the last meeting. Guidance on economic resources can be found at the standards level.

~~7.20~~7.21 Economic resources are not assets unless they meet the three characteristics of assets. Physical form is not a necessary condition of an economic resource.

~~7.21~~7.22 An ~~item~~ economic resource is not an asset of an ~~public sector~~ entity if it lacks one or more of the essential characteristics. For example, an ~~item~~ economic resource does not qualify as an asset of an ~~public sector~~ entity if the ~~item~~ economic resource involves:

Commented [AR7]: Amended to make it clear that the item refers to an economic resource.

(a) no future economic benefits;

(b) future economic benefits~~, but~~ that the entity cannot obtain ~~them~~; or

(c) future economic benefits ~~that the entity may obtain~~, but the events that give the entity control of the benefits have not yet occurred.

7.23 The fact that an estimat~~ion is required~~e of the amount is required at which an economic resource is measured does not preclude it from being an asset.

LIABILITIES

Definition

~~7.22~~7.24 A **liability** is a present economic obligation of an entity to others as a result of past events, the settlement of which is expected to result in a future sacrifice of economic ~~resources~~benefits.

Commented [AR8]: Amended based on discussion at the last TF meeting. The TF concluded that the definition should refer to benefits as not all resources have economic benefits.

Characteristics

~~7.23~~7.25 Liabilities have three essential characteristics:

(a) they embody a duty or responsibility to others, leaving an entity little or no discretion to avoid settlement of the obligation;

(b) the duty or responsibility to others entails settlement by future transfer or use of economic resources, provision of goods or services, or other form of economic settlement at a specified or determinable date, on occurrence of a specified event, or on demand; and

(c) the event(s) obligating the entity has already occurred.

7.26 Economic obligations are not liabilities unless they meet the three characteristics of liabilities.

7.27 An economic obligation is not a liability of an entity if it lacks one or more of the essential characteristics. For example, an economic obligation does not qualify as a liability of an entity if the economic obligation involves:

(a) the ability to avoid settlement;

(b) no future sacrifice of economic benefits; or

(c) little or no discretion to avoid settlement of the obligation with economic benefits, but the event obligating the entity has not yet occurred.

~~7.24 Not all obligations of a public sector entity will meet the definition of a liability.~~

Commented [AR9]: Inserted to parallel the discussion in the asset side.

~~7.25~~7.28 Only present obligations, as contrasted with future obligations~~,~~ such as contractual obligations, can meet the definition of a liability.

~~7.26~~7.29 Only present obligations that are economic in nature can meet the definition of a liability. An economic obligation is one that is primarily financial in nature or financially quantifiable and would be settled through the sacrifice of economic ~~resources~~benefits. An economic obligation can be contrasted with social obligations such as maintaining the safety of the public.

Commented [AR10]: Amended to be consistent with the definition.

~~7.27~~7.30 The fact that estimation is required of the amount at which an obligation is measured does not preclude it from being a liability.

REVENUE AND ~~E~~EXPENSE

~~7.28~~7.31 ~~A r~~**Revenue**, including a gain, is an increase in assets or decrease in liabilities in the accounting period that results in an increase in net assets or decrease in net liabilities~~, other than those arising from ownership contributions~~.

Commented [AR11]: Amended as quality reviewer indicated that it was grammatically incorrect.

~~Ownership contributions are inflows of economic 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.~~

Commented [AR12]: Amended based on the discussion at the last TF meeting to remove reference to ownership contributions.

~~7.29~~7.32 ~~A r~~Revenue, other than a gain, can arise from:

(a) taxation;

(b) fines;

(c) penalties;

(d) the sale of goods;

(e) the rendering of services;

(f) income from investments;

(g) the use by others of the entity's economic resources yielding rent, interest, royalties or dividends; or

(h) receiving contributions such as grants, donations and bequests.

~~7.30 Revenues do not include borrowings, such as proceeds from debt issues or amounts collected on behalf of others.~~

~~7.31~~7.33 An **expense**, including a loss, is a decrease in assets or increase in liabilities in the accounting period that results in a decrease in net assets or an increase in net liabilities~~, other than those arising from ownership distributions~~.

~~Ownership distributions are outflows of resources from the entity, distributed to external parities in their capacity as owners, which return or reduce an interest in the financial position of the entity.~~

~~7.32~~7.34 An expense, other than a loss, can arise from:

(a) amortization of tangible capital assets;

(b) provision of services;

(c) production of goods; or

(d) usage of space (e.g.~~i.e.~~, rent).

~~7.33 Expenses do not include debt repayments.~~

~~7.34~~7.35 Gains and losses may arise in relation to the disposition of assets purchased for use and not for resale, and the liquidation or refinancing of debt and remeasurements.

~~7.35~~7.36 Although revenue~~s~~ and expense~~s~~ are defined in terms of changes in assets and liabilities, information about revenues and expenses is equally important to the information provided by assets and liabilities.

Commented [AR13]: Removed based on the discussion at the last TF meeting. The discussion on agency versus principle is located at the standards level (the proposed revenue standard). The revenue definition would lead a user to concluded that revenues do not include borrowings. As a result, this sentence is not required.

Commented [AR14]: Removed based on the discussion at the last TF meeting to remove reference to ownership distributions.

Commented [AR15]: Removed based on TF discussion. This sentence is not required as the expense definition would lead a user to note that expenses do not include debt repayments.

~~7.36 Ownership contributions and ownership distribution are not elements. Ownership interests may be evidenced by the entity having a formal equity structure. However, there may be instances where an entity is established without a formal equity structure. An ownership interest can also arise from the restructuring of public sector entities, such as when a new government department is created.~~

~~7.37 Ownership contributions may take the form of an initial injection of resources at the creation of an entity or a subsequent injection of resources, including those where an entity is restructured, to allow the recipient to have the capacity to provide a new line of goods or services or perform other responsibilities. Such contributions represent an investment by the owner that is intended to result in future revenues sufficient to maintain the owner's investment, without on-going subsidies from the owner. When an entity receives government assistance available to all organizations (whether in the private or public sector), such amounts are revenue, not ownership contributions.~~

~~7.38 Ownership distributions may be: (a) a return on investment; (b) a full or partial return of investment; or (c) in the event of the entity being wound up or restructured, a return of any residual resources.~~

~~It is important to distinguish inflows of resources from owners, including those inflows that initially establish the ownership interest, and outflows of resources to owners in their capacity as owners from revenue and expense. Where such transfers satisfy the definitions of ownership contributions or ownership distributions, they will be accounted for as such.~~

~~7.39~~7.37 Revenue and expense are included in the period's surplus or deficit. However, in exceptional circumstances, certain revenues and expenses may be reflected directly in net assets or net liabilities.

Commented [AR16]: Removed based on discussion at the last TF meeting to remove reference to ownership contributions and ownership distributions.

Commented [AR17]: Inserted based on the discussion at the last TF meeting to signal the fact that not all revenues and expenses are reflected in surplus or deficit.

Appendix X — Explanations of the Decisions Made

Why ~~D~~deferrals are not an ~~E~~element

X.01 PSAB began considering deferrals in response to a report submitted by a sub-group of the Joint Working Group ~~(JWG)~~ comprised of selected PSAB members and deputy ministers of finance. In considering deferrals, PSAB identified three options:

(a) defining deferred inflows and deferred outflows as elements;

(b) broadening the asset and liability definitions to include items that are deferrals; or

(c) not including deferred inflows and deferred outflows in the conceptual framework.

X.02 Consultation Paper 2, "Measuring Financial Performance in Public Sector Financial Statements," requested feedback on option (a) and (c) by proposing three possible reporting models (i.e., the asset and liability model, the revenue and expense model and a hybrid model). Specifically, both the revenue and expense and hybrid models introduced the concept of deferred inflows and deferred outflows; the revenue and expense model defining them as elements and the hybrid model identifying them as components of net assets or net liabilities. The option of exploring a broadening of the asset and liability definitions to include items that are deferrals was not pursued primarily because it was considered important for the asset and liability definitions to be substantially consistent with those used in the rest of the world.

X.03 Out of the three reporting models provided in Consultation Paper 2, an asset and liability based reporting model was endorsed by a majority of respondents. The revenue and expense model was not endorsed by a majority of respondents for various reasons, including:

(a) it is difficult to develop a solid, objective and consistent basis for deferring inflows and outflows to future periods; ~~and~~

(b) the public understands assets and liabilities and changes in them (revenue and expense); and

~~(b)~~(c) accounting creations like deferrals would confuse the accountability for financial performance and financial position provided through the financial statements.

X.04 The public and its elected representatives hold assets and liabilities themselves in the form of cars, investments, houses, mortgages and credit card debt. They can be exposed to foreign currency risk, such as when they take vacations abroad and are familiar with changes in their investment portfolio resulting from fair value measurements. They also understand what the changes in them mean.

X.05 Under the asset and liability model, the elements of financial statements are limited to economic phenomena (assets and liabilities) and changes in them (revenue and expense~~s~~). Their nature ~~of them~~ can be understood and explained ~~as they relate to economic phenomena~~ and, thus, they can be effectively employed for providing accountability information to the public and their elected representatives. ~~As a result, PSAB concluded that deferred inflows and deferred outflows should not be elements in the conceptual framework.~~

Commented [AR18]: Moved the conclusion to the end of the section.

X.06 The understandability imperative that flows from the accountability objective comes into play in determining what elements ~~should~~ would be. Accountability is not achieved when those to whom an entity is accountable cannot understand the financial statement information provided to them for accountability purposes.

X.07 An ~~public sector~~ entity's finances are more complex than those of individuals. ~~P~~~~And public sector e~~Entities do things that individuals do not do. So ~~public sector~~ entities cannot and should not recognize only items that resemble those of an individual. However, to improve accountability, ~~public sector~~ entities should represent and explain their financial position and financial performance using building blocks that are familiar to the public, such as~~,~~ assets and liabilities and changes in them.

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~~X.07~~X.08 PSAB concluded that deferred inflows and deferred outflows would not be elements in the conceptual framework.

Why ~~N~~net assets or net ~~/~~liabilities is a ~~R~~residual amount rather ~~T~~than an ~~E~~element

~~X.08~~X.09 The conceptual framework in the PSA Handbook does not currently define net assets or net~~/~~ liabilities as an element of financial statements.

~~X.09~~X.10 FINANCIAL STATEMENT CONCEPTS FOR NOT FOR PROFIT ORGANIZATIONS, ~~Section~~ paragraph 1001.31 of Part III of the CPA Canada Handbook – Accounting ~~Handbook~~, defines net assets as an element as follows:

> .31 Net assets, sometimes referred to as equity or fund balances, is the residual interest in its assets after deducting its liabilities. Net assets may include specific categories of items whose uses may be either restricted or unrestricted.

~~X.10~~X.11 Net assets is defined as an element in ~~those standards~~Part III because equity is defined as an element. Equity is the term used for profit-oriented enterprises. Net assets is the equivalent for not-for-profit organizations. Equity is defined as a residual interest that includes specific categories of items~~,~~ (for example, types of share capital, contributed surplus and retained earnings). Profit-oriented enterprises have external, legal ownership interests that must be reported on separately.

~~X.11~~X.12 In determining the approach ~~for~~ to net assets or net liabilities ~~for the public sector~~, a number of options were considered:

(a) Retaining the PSA Handbook status quo. This approach would mean that there would be no net assets or net ~~/~~liabilities element and~~;~~ no contributions from or distributions to owners defined~~; and no items reflected directly in net assets/liabilities~~.

Commented [AR19]: Removed as in the current PSA Handbook remeasurements are reflected directly in net assets.

(b) Defining net assets or net ~~/~~liabilities as a residual amount but not as an element and, thus,~~;~~ treating any ownership interest as a sub-~~classification~~ category of net assets or net liabilities~~;~~ and defining contributions from and distributions to owners. This approach is similar to that of the International Public Sector Accounting Standards Board (IPSASB).

(c) Defining net assets or net~~/~~ liabilities as an element that is a residual amount but includes an ownership interest. This approach is similar to that in Part III of the CPA Canada Handbook – ~~=~~ Accounting ~~(Part III)~~.

(d) Defining one or more components of net assets or net ~~/~~liabilities as elements.

~~X.12~~X.13 A further option considered different ~~options~~ alternatives for governments and government organizations that would be tailored to the type of accountability that the users of their financial statements require. For example, the users of the financial statements of government organizations using not-for-profit accounting may expect additional accountability for resource flows unique to that type of organization ~~(e.g., endowments)~~.

~~X.13~~X.14 It was concluded that there should be one conceptual framework and one set of standards (i.e. GAAP) for all public sector entities that apply the PSA Handbook. These core requirements do not restrict a government organization from providing supplemental presentations and disclosures. Chapter 9, “Presentation Concepts,” provides the criteria to consider in determining whether supplemental presentations and disclosures are appropriate.

~~X.14~~X.15 The fourth option, which required defining one or more components of net assets or net~~/~~ liabilities as elements, was rejected because it contradicts the idea of elements as the most basic building blocks of financial statements. Elements may have sub~~-~~categories but elements cannot be sub~~-~~categories of something else. This is contrary to their fundamental nature.

~~X.15~~X.16 PSAB decided not to define net assets or net ~~/~~liabilities as an element for the following reasons:

(a) Net assets or net ~~/~~liabilities is a residual amount, calculated as the difference between assets and liabilities.

(b) Ownership interests are rare or minimal in the public sector. The existence of rare ownership interests should not drive the development of concepts in the conceptual framework.

(c) The parties interested in the financial position and results of a public sector entity are interested because they have expectations of future service delivery and other policy initiatives, rather than a return on investment.

(d) The calculation of n~~N~~et assets or ~~/~~net liabilities does not include a non-controlling external ownership interest. The PSA Handbook requires proportionate consolidation of entities that are not wholly owned. Any non-controlling external ownership interest is not reflected in public sector financial statements.

~~X.16~~X.17 Government organizations that determine that a ~~further~~ breakdown of net assets or net liabilities is necessary for the organization to meet management needs or other accountabilities~~,~~ would have the option to provide such a breakdown in the notes in accordance with PUBLIC SECTOR GUIDELINE PSG-4, Funds and Reserves~~FUNDS AND RESERVES, PSG-4~~.

~~X.17~~X.18 Being defined as, or considered, a residual amount does not mean that net assets or net~~/~~ liabilities is meaningless. It provides a measure of the net economic resources available to, or owing by, an entity at a point in time, a measure of sustainability. The service capacity discussion in Chapter ~~5~~4 provides further clarification on the significance of this indicator.

~~X.18 PSAB acknowledges that part of net assets/liabilities can in certain circumstances be an ownership interest. As a result PSAB decided to introduce ownership contributions and ownership distributions as aspects of net assets. However, occurrences of ownership contributions and~~

~~distributions are rare. As a result PSAB decided that ownership contributions and ownership distributions would not be elements.~~

Commented [AR20]: Removed as this is no longer the case based on the conclusion at the last TF meeting to remove ownership contributions and ownership distributions.

Why "~~E~~expectation" is retained in the ~~A~~asset and ~~L~~liability ~~D~~definitions

X.19 Consultation Paper 3 suggested replacing the notion in the asset and liability definitions that an inflow or outflow of resources is expected~~,~~ with the notion that an asset (or a liability) is capable of generating economic benefits (or sacrificing economic resources). Many respondents stated that PSAB should retain the notion of an expected inflow or outflow of ~~resources~~ economic benefits in the definitions. They argued that defining an asset as being "capable of providing future economic benefits" or defining a liability as "able to result in the future sacrifice of economic resources" would considerably widen the range of items that would be identified as assets and liabilities. This approach could lead to:

Commented [AR21]: Amended to be consistent with the wording in the asset and liability definitions.

(a) pressure to identify every possible asset and liability, imposing a significant operational burden, for little benefit if ultimately the asset or the liability is not recogniz~~s~~ed or is measured at nil;

(b) a presumption that, in principle, all assets and liabilities should be recogniz~~s~~ed even if inflows or outflows are not expected; and

(c) pressure for irrelevant disclosure about unrecogniz~~s~~ed assets and liabilities that are not expected to be realized.

X.20 The intent was not to increase the items considered to be assets and liabilities or create the consequences identified by respondents. The intent was to:

(a) remove an existing redundancy between the element definitions and the general recognition criteria; and

(b) leave the parameters that determine which assets and liabilities are recognized in financial statements to the general recognition criteria.

X.21 Based on the feedback received, PSAB decided to retain "expectation of realization" in the asset and liability definitions. This is a pragmatic choice. Removing the existing redundancy between the asset and liability definitions and the recognition criteria, while theoretically sound, is unlikely to add value, but likely to add an unnecessary reporting burden.

~~Asset and Liability Definition~~ Improvements to the asset and liability definitions

X.22 The existing asset and liability definitions have been modified to ~~make them~~be singular and constructed in a parallel fashion.

X.23 The asset definition has been amended as follows:

An assets ~~are~~ is a present economic resources controlled by ~~a government~~ an entity as a result of past ~~transactions or~~ events and from which future economic benefits are expected to be obtained.

X.24 The liability definition has been amended as follows:

A ~~L~~liabilityies ~~are~~ is a present economic obligations of an entity ~~government~~ to others as a result of ~~arising from~~ past ~~transactions or~~ events, the settlement of which is expected to result in the future sacrifice of economic benefits.

X.25 The main difference between the existing asset definition and that being proposed is the addition of "present" in front of economic resource. P~~The word "p~~resent" was inserted to refer to the existence of the economic resource at the financial statement reporting date. The intention ~~was~~is to make the asset definition more precise.

X.26 The main difference between the existing liability definition and that being proposed is the addition of "economic" in front of obligation. ~~The word~~ E~~"e~~conomic~~"~~ was inserted to refer to nature of the obligation. The intention ~~was~~is to make the liability definition more precise.

~~X.26~~X.27 As a result of these changes, each definition ~~as proposed~~ reflects:

(a) the present nature of the resource or obligation;

(b) the economic nature of the present resource or obligation;

(c) the association of the present economic resource or obligation with the entity; and

(d) the expectation of the present economic resource or obligation of the entity to provide economic benefits to or require sacrifice of ~~resources~~ economic benefits from the entity.

~~X.27~~X.28 "Transactions" has been removed from the definitions as it is a subset of "events".

X.29 These revisions are proposed in order to make the similarities and differences in the definitions clearer and assist in their application. No change in the substance to the definitions is intended by PSAB.

Guidance related to the asset and liability definitions

~~X.28~~X.30 Both the International Accounting Standards Board (IASB) and IPSASB have provided guidance in relation to their elements in the elements chapter of their conceptual framework. In the PSA Handbook, the

Commented [AR22]: Inserted based on the discussion at the last TF meeting.

Commented [AR23]: Amended to be consistent with the wording in the asset and liability definitions.

detailed guidance for the elements is found in individual standards (i.e., LIABILITIES, Section PS 3200, ~~*Liabilities,*~~ and ASSETS, Section PS 3210~~,~~ ~~*Assets*~~) rather than the conceptual framework. This approach emphasizes the requirement for all items that meet the definition of an element to be recognized in the financial statements regardless of whether a specific PSA Handbook standard exists. Chapter 8, ~~The~~ "Recognition and Measurement," ~~chapter~~ includes a paragraph that also explains this requirement.

~~Revenue and Expense Definitions~~ Improvements to the revenue and expense definitions

~~X.29~~X.31 No major issues have been raised with the definitions of revenue and expense in the PSA Handbook. However, since the project mandate is to consider the concepts underlying financial performance, a review was conducted to consider if any changes are needed to the definitions or to confirm the existing ones.

~~X.30~~X.32 Given that the input received from ~~the public sector community~~stakeholders in response to Consultation Paper 2 indicated a preference for an asset and liability based reporting model, it was concluded that revenue~~s~~ and expense~~s~~ should continue to be defined only in terms of changes in assets and liabilities.

~~X.31~~X.33 Based on the review of the revenue and expense definitions, it is proposed that the revenue and expense definitions require that the related inflows or outflows of economic resources result in a net increase or decrease in net assets or net liabilities. The reference to a net increase or decrease in net assets or net liabilities is required because some changes in assets and liabilities do not result in an increase or decrease in net assets or net liabilities. Some changes in assets or liabilities do not give rise to revenue or expense but instead to equal but opposite changes in other assets and liabilities. For example, debt repayments decrease assets and liabilities at the same time and~~,~~ in the same amount, but do not result in revenue~~s~~ or expense~~s~~. T~~and t~~hus, they do not result in any net change in net assets or net liabilities. The existing definitions don't require that an inflow or outflow create a net increase or decrease in net economic resources. Guidance after the definitions excludes debt proceeds and debt repayments and other similar items from being revenue~~s~~ and expense~~s~~. It was concluded that the definitions of revenue~~s~~ and expense~~s~~ should stand on their own. As a result, the requirement for a net impact on net assets or net liabilities was added to each definition.

~~X.32~~X.34 There have been developments, both domestically and internationally, in element definitions since the ~~PSA Handbook~~ conceptual framework was last considered. It was appropriate, therefore, to consider if any changes made by other standard setters also make sense for the public sector in Canada. Experience with the existing definitions and their application was also reviewed in order to assess the need for changes to the definitions. The review considered:

(a) whether the revenue and expense definitions should include gains and losses respectively; and

(b) other general improvements.

~~X.33~~X.35 The existing PSA Handbook definitions of revenue and expense include gains as revenue and losses as expense. A review of the work of other standard setters indicates that most do not separate between revenue~~s~~ ~~from~~ and gains or expense~~s~~ ~~from~~ and losses. Gains and losses do not differ from other revenues and expenses in their substance in that they are increases or decreases in assets or liabilities that result in increases or decreases in net assets or net liabilities.

~~X.34~~X.36 However, differentiating between revenue~~s~~ and a gain~~s~~, and an expense~~s~~ and a loss~~es~~ may be done for presentation purposes. The usefulness and need for such distinctions may vary depending on the nature of the entity, its operations, and its other activities. Items that are revenue~~s~~ for one kind of entity may be gains for another, and items that are losses for one kind of entity may be expense~~s~~ for another. In the past, gains and losses were often identified as arising primarily from peripheral activities of an entity as contrasted with normal operating activities. Thus, a distinction of gains from revenues and losses from expenses was used to refine the reporting of results from operations. However, it may not be appropriate to identify gains and losses arising on financial instruments carried at fair value as “peripheral items”, even though they are unrealized. For some ~~public sector~~ entities such gains and losses can be material and directly related to their mandate. For example, some governments concentrate management of their financial instruments primarily in one ~~public sector~~ entity. The separation of revenue and expense from gains and losses respectively for display purposes is not an element question. Element definitions should not be used to make distinctions of display or presentation. Thus, revenues and expenses would continue to include gains and losses respectively.

~~X.35~~X.37 Lastly, it was concluded that the revenue~~s~~ and expense~~s~~ definitions should be refined by:

(a) making them singular, consistent with the asset and liability definitions;

(b) removing unnecessary detail; and

(c) constructing them in a parallel fashion as appropriate.

~~X.36~~X.38 In relation to this conclusion, the following general characteristics of the revenue and expense definitions should be noted:

(a) The definitions associate the changes in assets and liabilities with the accounting period as financial statements measure financial performance on a periodic basis.

(b) The definitions need not include phrases associating them with the entity as revenue~~s~~ and expense~~s~~ arise only from changes in assets and liabilities and the definitions of assets and liabilities associate the related economic resources and obligations with the entity.

(c) The definitions make more specific reference to changes in net assets or net liabilities.

~~(d) The definitions exclude ownership contributions and distributions from revenues and expenses respectively. These are proposed to be defined concepts and are different in substance from other changes in assets and liabilities as these flows of resources arise in relation to individuals acting in an ownership capacity.~~

Commented [AR24]: Removed as this is no longer the case based on the decision to remove ownership contributions and ownership distributions.

~~X.37~~X.39 The revenue definition has been amended as follows:

Revenue~~s~~, including a gain~~s~~, ~~are~~ is an increase~~s~~ in ~~economic resources, either by way of increases of~~ assets or decrease~~s~~ in liabilities in the accounting period that results in an increase in net assets or a decrease in net liabilities.~~, resulting from the operations, transactions and events of the accounting period.~~

~~X.38~~X.40 The expense definition has been amended as follows:

An expense~~s~~, including a loss~~es~~, ~~are~~ is a decrease~~s~~ in ~~economic resources, either by way of decreases in~~ assets or increase~~s~~ in liabilities in the accounting period that results in a decrease in net assets or an increase in net liabilities.~~, resulting from the operations, transactions and events of the accounting period.~~

Importance of all statements in the financial statement package

~~X.39~~X.41 Although revenue~~s~~ and expense~~s~~ are defined in terms of changes in assets and liabilities, information about revenues and expenses is just as important as the information provided by assets and liabilities.

~~X.40~~X.42 Deriving revenue and expense definitions from changes in assets and liabilities does not mean that PSAB focuses solely or primarily on the statement of financial position. Financial statements are intended to provide information about an entity's financial performance and financial position. Hence, when making decisions about recognition, measurement, ~~and~~ presentation and disclosure, PSAB considers whether the resulting information provides information useful for accountability purposes about both an entity's financial performance and its financial position. PSAB has not designated one type of information (about financial position or about financial performance) as the primary focus of financial reporting.

~~X.41~~X.43 Identifying revenue~~s~~ and expense~~s~~ necessarily leads to identifying which assets and liabilities have changed. Standard setters have concluded that it is more effective, efficient, internally consistent and rigorous to define assets and liabilities first, and to define revenue and expense~~s~~ in terms of changes in assets and liabilities. It is difficult to define revenue~~s~~ and expense~~s~~ understandably without reference to asset and liabilities. If revenue~~s~~ and expense~~s~~ are defined first, assets and liabilities then become merely by-products of the recognition of revenue~~s~~ and expense~~s~~ rather than representations of economic phenomena.

X.44 Any definitions of revenue and expense~~s~~ crafted without reference to assets and liabilities are primarily conventional, not conceptual, and make periodic measurement of financial performance largely a matter of individual judgment and personal opinion. Using the asset and liability definitions as the anchor imposes limits or restraints not only on what can be included in ~~assets and liabilities~~financial position but also what can be included in financial performance.

Presentation location for revenue and expense

X.45 Revenue and expense should be included in the period's surplus or deficit. However, in exceptional circumstances certain revenues and expenses may be reflected directly in net assets or net liabilities. Only PSAB determines which revenue and expense are reflected in surplus or deficit and which revenue and expense are reflected in a component of net assets at the standards level, following the appropriate due process.

Commented [AR25]: Inserted to signal the fact that not all revenues and expenses are reflected in surplus or deficit.