

PUBLIC BENEFIT ENTITIES' *FRAMEWORK*

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PUBLIC BENEFIT ENTITIES' *FRAMEWORK*

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PUBLIC BENEFIT ENTITIES' FRAMEWORK

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The PBE *Framework* is set out in paragraphs 1–110. The PBE *Framework* is based on the New Zealand equivalent to the *IASB Conceptual Framework for Financial Reporting (2010): Part B – Public Benefit Entities Only* (NZ *Framework*: Part B).

The PBE *Framework* is a transitional framework for public benefit entities. It is issued pending the development and issuance of a conceptual framework by the International Public Sector Accounting Standards Board.

The PBE *Framework* continues to use the terminology adopted in New Zealand Equivalents to International Financial Reporting Standards (NZ IFRSs) to describe the financial statements and other elements. For example, the term “income” as used in this PBE *Framework* reflects the definition of that term in NZ IFRSs. The equivalent term in PBE Standards is “revenue”. Entities seeking to apply the PBE *Framework* may need to amend the descriptions used for particular line items in the financial statements and for the financial statements themselves. For example, capital or share capital may be referred to as net assets/equity.

Introduction to the PBE Framework

The PBE Framework is based on the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2010): Part B – Public Benefit Entities Only (NZ Framework: Part B). The PBE Framework is an essential component of New Zealand financial reporting pronouncements as it establishes definitions and recognition criteria that are applied in other pronouncements that are relevant to public benefit entities.

The original document on which the PBE Framework is based is the IASB *Framework for the Preparation and Presentation of Financial Statements* (1989) (IASB Framework (1989)). The IASB Framework (1989) was developed for application by for-profit entities. The PBE Framework therefore includes additional material to ensure that it can be applied by public benefit entities required to prepare general purpose financial statements that comply with generally accepted accounting practice in New Zealand. In order to preserve the integrity of the IASB Framework (1989), changes to the text of the IASB Framework (1989) have been minimised.

Changes to, or material additional to, the text of the IASB Framework (1989) include:

- (a) The discussion in paragraphs 1–4 has been revised to reflect the purpose of the PBE Framework and the role of the New Zealand Accounting Standards Board (NZASB) (paragraphs 4.1 to 4.3).
- (b) A discussion that when an entity makes publicly available its approved budget, a complete set of financial statements also includes a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the financial statements. (paragraph 7).
- (c) A discussion acknowledging the role of non-financial and supplementary information (paragraph 7.1).
- (d) Additional paragraphs to acknowledge the range of entities that are required to prepare general purpose financial statements (paragraphs 8.1 to 8.3).
- (e) A discussion of additional users of financial statements (funders or financial supporters, and elected or appointed representatives) (paragraph 9.1).
- (f) A discussion of the role of financial statements in demonstrating accountability (paragraphs 14.1 and 14.2).
- (g) An additional paragraph to clarify that information about performance is useful in predicting the capacity of an entity to deliver services (paragraph 17.1).
- (h) A discussion of various types of non-financial and supplementary information (paragraphs 20.1 to 20.2).
- (i) Clarification that in order to be relevant, information must also be timely (paragraph 28.1).
- (j) Additional guidance in respect of materiality (paragraph 30.1).
- (k) An explanation that the term “income” is used in the PBE Framework when the equivalent term in PBE Standards is “revenue” (paragraph 47.1)
- (l) A discussion of the terms “future economic benefits” and “service potential” (paragraph 49.1).
- (m) An additional paragraph to highlight that performance in the context of public benefit entities has two aspects: financial and non-financial (paragraph 68.1).
- (n) Additional guidance stating that references to contributions from (or distributions to) equity participants should be read as contributions from (or distributions to) equity holders acting in their capacity as equity holders (paragraph 70.1).
- (o) A brief discussion of the elements of non-financial statements. The PBE Framework requires that the quality of the information presented in non-financial and supplementary information should be considered with regard to the qualitative characteristics and constraints on those qualitative characteristics discussed in paragraphs 24 to 45 of the PBE Framework (paragraphs 101.1 to 101.3).

Introduction

Purpose and Status

- 1–4. [Paragraphs 1 to 4 of the IASB *Framework* (1989) are not reproduced—they have been replaced by paragraph 4.1 which explains the purpose of this PBE *Framework*.]
- 4.1 The PBE *Framework* sets out the concepts that underlie the preparation and presentation of financial reports by public benefit entities required to prepare general purpose financial statements that comply with PBE Standards.¹ The IASB *Framework* (1989), on which this PBE *Framework* is based, focuses on financial statements. However, financial statements are often presented in conjunction with other information. A financial report may include financial statements, non-financial statements and supplementary information. To ensure the relevance of the PBE *Framework* for public benefit entities, certain aspects have been extended to acknowledge the role of non-financial and supplementary information. These paragraphs are clearly marked. The purpose of the PBE *Framework* is to:
- (a) Assist the New Zealand Accounting Standards Board (NZASB) in its role in commenting on the development of International Public Sector Accounting Standards (IPSASs) by the International Public Sector Accounting Standards Board (IPSASB);
 - (b) Assist the NZASB in developing PBE Standards;
 - (c) Assist preparers of financial statements in dealing with topics that have yet to form the subject of a PBE Standard;
 - (d) Assist auditors in forming an opinion as to whether financial statements conform with PBE Standards; and
 - (e) Assist users of financial statements in interpreting the information contained in financial statements.
- 4.2 The PBE *Framework* is not a Standard and hence does not define standards for any particular definition, recognition, measurement or disclosure issue. Nothing in this PBE *Framework* overrides any specific Standard. PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* outlines the requirements for developing accounting policies in the absence of a Standard that specifically applies to a transaction, other event or condition.
- 4.3 The NZASB recognises that in a limited number of cases there may be a conflict between the PBE *Framework* and a specific Standard. In those cases where there is a conflict, the requirements of the Standard prevail over those of the PBE *Framework*.

Scope

5. The PBE *Framework* deals with:
- (a) The objective of financial statements;
 - (b) The qualitative characteristics that determine the usefulness of information in financial statements and statements of service performance;
 - (c) The definition, recognition and measurement of the elements from which financial statements are constructed; and
 - (d) Concepts of capital and capital maintenance.
6. The PBE *Framework* is concerned with general purpose financial statements (hereafter referred to as “financial statements”), including consolidated financial statements. Such financial statements are prepared and presented at least annually and are directed toward the common information needs of a wide range of users. Some of these users may require, and have the power to obtain, information in addition to that contained in the financial statements. Many users, however, have to rely on the financial statements as their major source of financial information and such financial statements should, therefore, be prepared and presented with their needs in view. Special purpose financial reports, for example, prospectuses and

¹ External Reporting Board Standard A1 *Accounting Standards Framework* (XRB A1) identifies the standards to be applied by public benefit entities that have a statutory obligation to prepare general purpose financial reports.

computations prepared for taxation purposes, are outside the scope of the *PBE Framework*. Nevertheless, the *PBE Framework* may be applied in the preparation of such special purpose reports where their requirements permit.

7. Financial statements form part of the process of financial reporting. A complete set of financial statements normally includes a balance sheet, an income statement, a statement of cash flows and a statement of changes in equity, and those notes and other statements and explanatory material that are an integral part of the financial statements. When the entity makes publicly available its approved budget, a complete set of financial statements also includes a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the financial statements. They may also include supplementary schedules and information based on or derived from, and expected to be read with, such statements. Such schedules and supplementary information may deal, for example, with disclosures about the effects of changing prices. Financial statements do not, however, include such items as reports by directors, statements by the chairman, discussion and analysis by management and similar items that may be included in an annual or interim report.
- 7.1 A financial report may include financial statements, non-financial statements such as statements of service performance and supplementary information which is additional to the information in financial statements.
8. The *PBE Framework* applies to the financial reports of Tier 1 and Tier 2 public benefit entities. A reporting entity² is an entity for which there are users who rely on the financial statements as their major source of financial information about the entity.
- 8.1 An obligation to prepare general purpose financial reports often derives from legislation, regulations, common law, an entity's constitution or contractual arrangements.
- 8.2 Types of reporting entities include government departments, Crown entities, local authorities, entities such as trusts and charities, and for-profit entities such as companies. The financial reporting requirements that are applicable to public benefit entities are set out in *PBE Standards*.³
- 8.3 The application of this *PBE Framework* is outlined in paragraph 4.1.

Users and their Information Needs

9. The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public. They use financial statements in order to satisfy some of their different needs for information. These needs include the following:
 - (a) *Investors.* The providers of risk capital and their advisers are concerned with the risk inherent in, and return provided by, their investments. They need information to help them determine whether they should buy, hold or sell. Shareholders are also interested in information which enables them to assess the ability of the entity to pay dividends.
 - (b) *Employees.* Employees and their representative groups are interested in information about the stability and profitability of their employers. They are also interested in information which enables them to assess the ability of the entity to provide remuneration, retirement benefits and employment opportunities.
 - (c) *Lenders.* Lenders are interested in information that enables them to determine whether their loans, and the interest attaching to them, will be paid when due.
 - (d) *Suppliers and other trade creditors.* Suppliers and other creditors are interested in information that enables them to determine whether amounts owing to them will be paid when due. Trade creditors are likely to be interested in an entity over a shorter period than lenders unless they are dependent upon the continuation of the entity as a major customer.

² This definition of a reporting entity differs from that used in the Financial Reporting Act 2013. The Financial Reporting Act 2013 defines a "reporting entity" as "an entity whose financial statements, or group financial statements, reports or other information is required by any enactment to comply, or be prepared in accordance, with generally accepted accounting practice or non-GAAP standards".

³ XRB Standard A1 *Accounting Standards Framework* contains guidance on determining whether an entity is a public benefit entity.

- (e) *Customers including service recipients.* Customers have an interest in information about the continuance of an entity, especially when they have a long-term involvement with, or are dependent on, the entity.
 - (f) *Governments and their agencies.* Governments and their agencies are interested in the allocation of resources and, therefore, the activities of entities. They also require information in order to regulate the activities of entities, determine taxation policies and as the basis for national income and similar statistics.
 - (g) *Public.* Entities affect members of the public in a variety of ways. For example, entities may make a substantial contribution to the local economy in many ways, including the number of people they employ and their patronage of local suppliers. Financial statements may assist the public by providing information about the trends and recent developments in the prosperity of the entity and the range of its activities.
- 9.1 The users of financial statements in the New Zealand context also include funders and financial supporters (for example, taxpayers and donors), and elected or appointed representatives. Their needs include the following:
- (a) *Funders or financial supporters.* Funders or financial supporters provide a source of cash and/or resources that does not generate a direct return (unlike a loan) and is not provided in exchange for direct benefits (goods or services) for themselves. The funder or financial supporter generally provides taxation, grants or donations to the entity. This class of users includes the past, present and potential funders and financial supporters of the entity. When funders and financial supporters provide resources that are used to supply goods and services to third parties they are interested in the quality of the goods and services produced and whether the goods and services were produced in accordance with relevant contracts or agreements. As with customers that purchase goods and services directly from an entity, funders and financial supporters are interested in information about the continuance of an entity, such as its sustainability, flexibility and vulnerability.
 - (b) *Elected or appointed representatives.* Members of Parliament and local authority councillors represent their respective electorates. Members of a governing body represent the interests of specific groups or entities. Elected or appointed representatives use financial statements to assess an entity's actual achievement against its formal objectives and targets and hold an entity accountable for its performance. Such users are likely to use financial statements in conjunction with non-financial information. Where the elected or appointed representatives have responsibility for the long-term financial performance of an entity they may also be interested in its sustainability, flexibility and vulnerability.
10. [Not used.]
11. The management⁴ of an entity has the primary responsibility for the preparation and presentation of the financial statements of the entity. Management is also interested in the information contained in the financial statements even though it has access to additional management and financial information that helps it carry out its planning, decision-making and control responsibilities. Management has the ability to determine the form and content of such additional information in order to meet its own needs. The reporting of such information, however, is beyond the scope of the *PBE Framework*. Nevertheless, published financial statements are based on the information used by management about the financial position, performance and changes in financial position of the entity.

The Objective of Financial Statements

- 12. The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.
- 13. Financial statements prepared for this purpose meet the common needs of most users. However, financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information.

⁴ The term "key management personnel" is defined in PBE IPSAS 20 *Related Party Disclosures*.

14. Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it. Those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the entity or whether to reappoint or replace the management.
- 14.1 In addition to making economic decisions, as discussed in paragraphs 12 to 14, users of financial statements of New Zealand entities may also be interested in how well an entity has demonstrated its accountability in relation to a range of obligations including the entity's compliance with legislation, regulations, common law and contractual arrangements.
- 14.2 An entity may demonstrate its accountability in relation to its obligations in its financial statements or in non-financial statements and other supplementary information. Accountability requires that an entity reflect the nature and dimensions of performance that are relevant to the entity by:
 - (a) Identifying the objectives and targets (financial or non-financial) normally established by formal process; and
 - (b) Recognising, measuring and disclosing actual achievements in relation to those objectives and targets.

Financial Position, Performance and Changes in Financial Position

15. The economic decisions that are taken by users of financial statements require an evaluation of the ability of an entity to generate cash and cash equivalents and of the timing and certainty of their generation. This ability ultimately determines, for example, the capacity of an entity to pay its employees and suppliers, meet interest payments, repay loans and make distributions to its owners. Users are better able to evaluate this ability to generate cash and cash equivalents if they are provided with information that focuses on the financial position, performance and changes in financial position of an entity.
16. The financial position of an entity is affected by the economic resources it controls, its financial structure, its liquidity and solvency, and its capacity to adapt to changes in the environment in which it operates. Information about the economic resources controlled by the entity and its capacity in the past to modify these resources is useful in predicting the ability of the entity to generate cash and cash equivalents in the future. Information about financial structure is useful in predicting future borrowing needs and how future surpluses and cash flows will be distributed among those with an interest in the entity; it is also useful in predicting how successful the entity is likely to be in raising further finance. Information about liquidity and solvency is useful in predicting the ability of the entity to meet its financial commitments as they fall due. Liquidity refers to the availability of cash in the near future after taking account of financial commitments over this period. Solvency refers to the availability of cash over the longer term to meet financial commitments as they fall due.
17. [Not used.]
- 17.1 Information about the performance of an entity, including its service delivery and financial performance, and the variability of that performance, is required in order to assess potential changes in the economic resources that the entity is likely to control in the future. Information about performance is useful in predicting the capacity of the entity to deliver services from its existing resource base. It is also useful in forming judgements about the effectiveness with which the entity might employ additional resources.
18. Information concerning changes in the financial position of an entity is useful in order to assess its investing, financing and operating activities during the reporting period. This information is useful in providing the user with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilise those cash flows. In constructing a statement of changes in financial position, funds can be defined in various ways, such as all financial resources, working capital, liquid assets or cash. No attempt is made in this PBE *Framework* to specify a definition of funds.
19. Information about financial position is primarily provided in a balance sheet. Information about performance is primarily provided in an income statement. Information about changes in financial position is provided in the financial statements by means of a separate statement.
20. The component parts of the financial statements interrelate because they reflect different aspects of the same transactions or other events. Although each statement provides information that is different from the others, none is likely to serve only a single purpose or provide all the information necessary for

particular needs of users. For example, an income statement provides an incomplete picture of performance unless it is used in conjunction with the balance sheet and the statement of changes in financial position.

Non-financial and Supplementary Information

- 20.1 In order to assist users of financial statements in making economic decisions and in forming assessments of an entity's accountability for its obligations, an entity may provide a range of non-financial and supplementary information including
- (a) Historical information;
 - (b) Interpretive comment;
 - (c) Prospective information;
 - (d) Service performance information;
 - (e) Information on compliance with legislation; and
 - (f) Key value driver information.
- 20.2 Historical information reports on past transactions and events.
- 20.3 Interpretive comment reports on reported results. For example, narrative comment could explain the relationship between material changes in financial elements and the entity's history, objectives, current activities and changes in the external environment (including the economic, physical and social environment) or objectives.
- 20.4 Prospective information reports on the potential effects of past transactions and events and the likely effects of proposed transactions and events. It is commonly disclosed in narrative and/or quantitative form. For example, narrative information could provide an assessment of the entity's future impacts and prospects, focusing on how anticipated changes in the external environment (including the economic, physical and social environment) might affect results, liquidity and risk. In contrast, quantitative information could take the form of predictive results for anticipated economic, social or environmental effects based on proposed courses of action.
- 20.5 Service performance is the term used to describe an entity's performance in meeting its objectives of supplying goods and services. An entity's service performance is assessed by comparing the entity's service performance results with its service performance objectives. Service performance objectives and results are reported in non-financial terms, such as quantities of goods and services provided.
- 20.6 An entity may have an obligation to report service performance when it receives funding from one party (the ratepayer, the donor etc) but delivers (or arranges to deliver) outputs (goods and services) to third parties (the general public, the disabled etc). This relationship occurs when the entity has the coercive power to tax, rate or levy to obtain public funds, or the entity receives donations from the public. For example, this relationship exists where the entity reporting is a charity that receives donations from the public but provides services to third parties such as the disabled. Similarly, a local authority may charge rates to property owners but provide a park and other services to the general public as third parties.
- 20.7 Entities have a range of legal obligations, including compliance with legislation governing health and safety, human resources and protection of the environment. Such obligations may impact upon financial performance, or information from the financial statements may be used to demonstrate an entity's commitment to these obligations. In addition, some entities have legal obligations to operate in accordance with approved budgets.
- 20.8 Non-financial information might also focus on identifying and describing the key business, operational and strategic factors facing an entity. Key value driver information can encompass a broad range of measures including sales growth, profit, client satisfaction, measures of the quality of goods and services, and supplier relationships.

Notes and Supplementary Schedules

21. The financial statements also contain notes and supplementary schedules and other information. For example, they may contain additional information that is relevant to the needs of users about the items in the balance sheet and income statement. They may include disclosures about the risks and uncertainties

affecting the entity and any resources and obligations not recognised in the balance sheet (such as mineral reserves). Information about geographical and industry segments and the effect on the entity of changing prices may also be provided in the form of supplementary information.

Underlying Assumptions

Accrual Basis

22. In order to meet their objectives, financial statements are prepared on the accrual basis of accounting. Under this basis, the effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate. Financial statements prepared on the accrual basis inform users not only of past transactions involving the payment and receipt of cash but also of obligations to pay cash in the future and of resources that represent cash to be received in the future. Hence, they provide the type of information about past transactions and other events that is most useful to users in making economic decisions.

Going Concern

23. The financial statements are normally prepared on the assumption that an entity is a going concern and will continue in operation for the foreseeable future. Hence, it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations; if such an intention or need exists, the financial statements may have to be prepared on a different basis and, if so, the basis used is disclosed.

Qualitative Characteristics of Financial Statements

24. Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

Understandability

25. An essential quality of the information provided in financial statements is that it is readily understandable by users. For this purpose, users are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand.

Relevance

26. To be useful, information must be relevant to the decision-making needs of users. Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.
27. The predictive and confirmatory roles of information are interrelated. For example, information about the current level and structure of asset holdings has value to users when they endeavour to predict the ability of the entity to take advantage of opportunities and its ability to react to adverse situations. The same information plays a confirmatory role in respect of past predictions about, for example, the way in which the entity would be structured or the outcome of planned operations.
28. Information about financial position and past performance is frequently used as the basis for predicting future financial position and performance and other matters in which users are directly interested, such as dividend and wage payments, security price movements and the ability of the entity to meet its commitments as they fall due. To have predictive value, information need not be in the form of an explicit forecast. The ability to make predictions from financial statements is enhanced, however, by the manner in which information on past transactions and events is displayed. For example, the predictive value of the income statement is enhanced if unusual, abnormal and infrequent items of income or expense are separately disclosed.
- 28.1 In addition, in order to be relevant, information must also be timely.

Materiality

29. The relevance of information is affected by its nature and materiality. In some cases, the nature of information alone is sufficient to determine its relevance. For example, the reporting of a new segment may affect the assessment of the risks and opportunities facing the entity irrespective of the materiality of the results achieved by the new segment in the reporting period. In other cases, both the nature and materiality are important, for example, the amounts of inventories held in each of the main categories that are appropriate to the business.
30. Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.
- 30.1 In addition, omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements.

Reliability

31. To be useful, information must also be reliable. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent.
32. Information may be relevant but so unreliable in nature or representation that its recognition may be potentially misleading. For example, if the validity and amount of a claim for damages under a legal action are disputed, it may be inappropriate for the entity to recognise the full amount of the claim in the balance sheet, although it may be appropriate to disclose the amount and circumstances of the claim.

Faithful Representation

33. To be reliable, information must represent faithfully the transactions and other events it either purports to represent or could reasonably be expected to represent. Thus, for example, a balance sheet should represent faithfully the transactions and other events that result in assets, liabilities and equity of the entity at the reporting date which meet the recognition criteria.
34. Most financial information is subject to some risk of being less than a faithful representation of that which it purports to portray. This is not due to bias, but rather to inherent difficulties either in identifying the transactions and other events to be measured or in devising and applying measurement and presentation techniques that can convey messages that correspond with those transactions and events. In certain cases, the measurement of the financial effects of items could be so uncertain that entities generally would not recognise them in the financial statements; for example, although most entities generate goodwill internally over time, it is usually difficult to identify or measure that goodwill reliably. In other cases, however, it may be relevant to recognise items and to disclose the risk of error surrounding their recognition and measurement.

Substance over Form

35. If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with that which is apparent from their legal or contrived form. For example, an entity may dispose of an asset to another party in such a way that the documentation purports to pass legal ownership to that party; nevertheless, agreements may exist that ensure that the entity continues to enjoy the future economic benefits or service potential embodied in the asset. In such circumstances, the reporting of a sale would not represent faithfully the transaction entered into (if indeed there was a transaction).

Neutrality

36. To be reliable, the information contained in financial statements must be neutral, that is, free from bias. Financial statements are not neutral if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

Prudence

37. The preparers of financial statements do, however, have to contend with the uncertainties that inevitably surround many events and circumstances, such as the collectability of doubtful receivables, the probable useful life of plant and equipment and the number of warranty claims that may occur. Such uncertainties are recognised by the disclosure of their nature and extent and by the exercise of prudence in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability.

Completeness

38. To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

Comparability

39. Users must be able to compare the financial statements of an entity through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different entities in order to evaluate their relative financial position, performance and changes in financial position. Hence, the measurement and display of the financial effect of like transactions and other events must be carried out in a consistent way throughout an entity and over time for that entity and in a consistent way for different entities.
40. An important implication of the qualitative characteristic of comparability is that users be informed of the accounting policies employed in the preparation of the financial statements, any changes in those policies and the effects of such changes. Users need to be able to identify differences between the accounting policies for like transactions and other events used by the same entity from period to period and by different entities. Compliance with PBE Standards, including the disclosure of the accounting policies used by the entity, helps to achieve comparability.
41. The need for comparability should not be confused with mere uniformity and accounting standards. It is not appropriate for an entity to continue accounting in the same manner for a transaction or other event if the policy adopted is not in keeping with the qualitative characteristics of relevance and reliability. It is also inappropriate for an entity to leave its accounting policies unchanged when more relevant and reliable alternatives exist.
42. Because users wish to compare the financial position, performance and changes in financial position of an entity over time, it is important that the financial statements show corresponding information for the preceding periods.

Constraints on Relevant and Reliable Information*Timeliness*

43. If there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. To provide information on a timely basis it may often be necessary to report before all aspects of a transaction or other event are known, thus impairing reliability. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have had to make decisions in the interim. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the economic decision-making needs of users.

Balance between Benefit and Cost

44. The balance between benefit and cost is a pervasive constraint rather than a qualitative characteristic. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a judgmental process. Furthermore, the costs do not necessarily fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the

information is prepared; for example, the provision of further information to lenders may reduce the borrowing costs of an entity. For these reasons, it is difficult to apply a cost-benefit test in any particular case. Nevertheless, standard-setters in particular, as well as the preparers and users of financial statements, should be aware of this constraint.

Balance between Qualitative Characteristics

45. In practice a balancing, or trade-off, between qualitative characteristics is often necessary. Generally the aim is to achieve an appropriate balance among the characteristics in order to meet the objective of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgment.

True and Fair View/Fair Presentation

46. Financial statements are frequently described as showing a true and fair view of, or as presenting fairly, the financial position, performance and changes in financial position of an entity. Although the *PBE Framework* does not deal directly with such concepts, the application of the principal qualitative characteristics and of appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of, or as presenting fairly such information.⁵

The Elements of Financial Statements

47. Financial statements portray the financial effects of transactions and other events by grouping them into broad classes according to their economic characteristics. These broad classes are termed the elements of financial statements. The elements directly related to the measurement of financial position in the balance sheet are assets, liabilities and equity. The elements directly related to the measurement of performance in the income statement are income and expenses. The statement of changes in financial position usually reflects income statement elements and changes in balance sheet elements; accordingly, this *PBE Framework* identifies no elements that are unique to this statement.
- 47.1 Consistent with the document on which this *PBE Framework* is based, the *PBE Framework* defines and describes “income” as an element directly related to the measurement of performance. In contrast, *PBE Standards*, including *PBE IPSAS 1 Presentation of Financial Statements*, define and describe “revenue” as an element. *PBE IPSAS 1* defines revenue as “the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners”. The definition of revenue in *PBE IPSAS 1* is equivalent to the term income in this *Framework*. All references to income in this *Framework* should therefore be read in the context of the definition of revenue in *PBE IPSAS 1*.
48. The presentation of these elements in the balance sheet and the income statement involves a process of sub-classification. For example, assets and liabilities may be classified by their nature or function in the business of the entity in order to display information in the manner most useful to users for purposes of making economic decisions.

Financial Position

49. The elements directly related to the measurement of financial position are assets, liabilities and equity. These are defined as follows:
- (a) An asset is a resource controlled by the entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.
 - (b) A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.
 - (c) Equity is the residual interest in the assets of the entity after deducting all its liabilities.
- 49.1 This *PBE Framework* refers to “future economic benefits” and “service potential”. Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity’s objectives but which do not directly generate net cash inflows are often

⁵ For details of regulatory requirements in New Zealand, refer to the Financial Reporting Act 2013, the Public Finance Act 1989 and the Local Government Act 2002. Refer also to *PBE IPSAS 1 Presentation of Financial Statements*, paragraphs 27 to 37.

described as embodying “service potential.” Assets that are used to generate net cash inflows are often described as embodying “future economic benefits.”

50. The definitions of an asset and a liability identify their essential features but do not attempt to specify the criteria that need to be met before they are recognised in the balance sheet. Thus, the definitions embrace items that are not recognised as assets or liabilities in the balance sheet because they do not satisfy the criteria for recognition discussed in paragraphs 82 to 98. In particular, the expectation that future economic benefits or service potential will flow to or from an entity must be sufficiently certain to meet the probability criterion in paragraph 83 before an asset or liability is recognised.
51. In assessing whether an item meets the definition of an asset, liability or equity, attention needs to be given to its underlying substance and economic reality and not merely its legal form. Thus, for example, in the case of finance leases, the substance and economic reality are that the lessee acquires the economic benefits or service potential of the use of the leased asset for the major part of its useful life in return for entering into an obligation to pay for that right an amount approximating to the fair value of the asset and the related finance charge. Hence, the finance lease gives rise to items that satisfy the definition of an asset and a liability and are recognised as such in the lessee’s balance sheet.
52. Balance sheets drawn up in accordance with PBE Standards may include items that do not satisfy the definitions of an asset or liability and are not shown as part of equity. The definitions set out in paragraph 49 will, however, underlie future reviews of existing Standards and the formulation of further Standards.

Assets

53. The future economic benefit or service potential embodied in an asset is the potential to contribute, directly or indirectly, to service delivery and/or to the flow of cash and cash equivalents to the entity. The potential may be a productive one that is part of the operating activities of the entity. It may also take the form of convertibility into cash or cash equivalents or a capability to reduce cash outflows, such as when an alternative manufacturing process lowers the costs of production.
54. An entity usually employs its assets to produce goods or services capable of satisfying the wants or needs of customers; because these goods or services can satisfy these wants or needs, customers are prepared to pay for them and hence contribute to the cash flow of the entity. Cash itself renders a service to the entity because of its command over other resources.
55. The future economic benefits or service potential embodied in an asset may flow to the entity in a number of ways. For example, an asset may be:
 - (a) Used singly or in combination with other assets in the production of goods or services;
 - (b) Exchanged for other assets;
 - (c) Used to settle a liability; or
 - (d) Distributed to the owners of the entity.
56. Many assets, for example, property, plant and equipment, have a physical form. However, physical form is not essential to the existence of an asset; hence patents and copyrights, for example, are assets if future economic benefits or service potential are expected to flow from them to the entity and if they are controlled by the entity.
57. Many assets, for example, receivables and property, are associated with legal rights, including the right of ownership. In determining the existence of an asset, the right of ownership is not essential; thus, for example, property held on a lease is an asset if the entity controls the benefits which are expected to flow from the property. Although the capacity of an entity to control benefits is usually the result of legal rights, an item may nonetheless satisfy the definition of an asset even when there is no legal control. For example, know-how obtained from a development activity may meet the definition of an asset when, by keeping that know-how secret, an entity controls the benefits that are expected to flow from it.
58. The assets of an entity result from past transactions or other past events. Entities normally obtain assets by purchasing or producing them, but other transactions or events may generate assets; examples include property received by an entity from government as part of a programme to encourage economic growth in an area and the discovery of mineral deposits. Transactions or events expected to occur in the future do

not in themselves give rise to assets; hence, for example, an intention to purchase inventory does not, of itself, meet the definition of an asset.

59. There is a close association between incurring expenditure and generating assets but the two do not necessarily coincide. Hence, when an entity incurs expenditure, this may provide evidence that future economic benefits were sought but is not conclusive proof that an item satisfying the definition of an asset has been obtained. Similarly the absence of a related expenditure does not preclude an item from satisfying the definition of an asset and thus becoming a candidate for recognition in the balance sheet; for example, items that have been donated to the entity may satisfy the definition of an asset.

Liabilities

60. An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities.
61. A distinction needs to be drawn between a present obligation and a future commitment. A decision by the management of an entity to acquire assets in the future does not, of itself, give rise to a present obligation. An obligation normally arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a substantial penalty, leave the entity with little, if any, discretion to avoid the outflow of resources to another party.
62. The settlement of a present obligation usually involves the entity giving up resources embodying economic benefits in order to satisfy the claim of the other party. Settlement of a present obligation may occur in a number of ways, for example, by:
- (a) Payment of cash;
 - (b) Transfer of other assets;
 - (c) Provision of services;
 - (d) Replacement of that obligation with another obligation; or
 - (e) Conversion of the obligation to equity.

An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

63. Liabilities result from past transactions or other past events. Thus, for example, the acquisition of goods and the use of services give rise to trade payables (unless paid for in advance or on delivery) and the receipt of a bank loan results in an obligation to repay the loan. An entity may also recognise future rebates based on annual purchases by customers as liabilities; in this case, the sale of the goods in the past is the transaction that gives rise to the liability.
64. Some liabilities can be measured only by using a substantial degree of estimation. Some entities describe these liabilities as provisions. In some countries, such provisions are not regarded as liabilities because the concept of a liability is defined narrowly so as to include only amounts that can be established without the need to make estimates. The definition of a liability in paragraph 49 follows a broader approach. Thus, when a provision involves a present obligation and satisfies the rest of the definition, it is a liability even if the amount has to be estimated. Examples include provisions for payments to be made under existing warranties and provisions to cover pension obligations.

Equity

65. Although equity is defined in paragraph 49 as a residual, it may be sub-classified in the balance sheet. For example, in a corporate entity, funds contributed by shareholders, retained earnings, reserves representing appropriations of retained earnings and reserves representing capital maintenance adjustments may be shown separately. Such classifications can be relevant to the decision-making needs of the users of financial statements when they indicate legal or other restrictions on the ability of the entity to distribute or otherwise

apply its equity. They may also reflect the fact that parties with ownership interests in an entity have differing rights in relation to the receipt of dividends or the repayment of capital.

66. The creation of reserves is sometimes required by statute or other law in order to give the entity and its creditors an added measure of protection from the effects of losses. Other reserves may be established if national tax law grants exemptions from, or reductions in, taxation liabilities when transfers to such reserves are made. The existence and size of these legal, statutory and tax reserves is information that can be relevant to the decision-making needs of users. Transfers to such reserves are appropriations of retained earnings rather than expenses.
67. The amount at which equity is shown in the balance sheet is dependent on the measurement of assets and liabilities. Normally, the aggregate amount of equity only by coincidence corresponds with the aggregate market value of the shares of the entity or the sum that could be raised by disposing of either the net assets on a piecemeal basis or the entity as a whole on a going concern basis.
68. Reporting entities may include sole proprietorships, partnerships and trusts and various types of government business undertakings. The legal and regulatory framework for such entities is often different from that applying to corporate entities. For example, there may be few, if any, restrictions on the distribution to owners or other beneficiaries of amounts included in equity. Nevertheless, the definition of equity and the other aspects of this *PBE Framework* that deal with equity are appropriate for such entities.

Performance

- 68.1 In the context of public benefit entities performance has two aspects: financial and non-financial. This section deals with financial performance. The elements of non-financial information are discussed in paragraphs 101.1 to 101.3.
69. Surplus is frequently used as a measure of financial performance for public benefit entities. The elements directly related to the measurement of surplus are income and expenses. The recognition and measurement of income and expenses, and hence surplus, depends in part on the concepts of capital and capital maintenance used by the entity in preparing its financial statements. These concepts are discussed in paragraphs 102 to 110.
70. The elements of income and expenses are defined as follows:
 - (a) Income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.
 - (b) Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.
- 70.1 References to contributions from, or distributions to, equity participants should be read as contributions from, or distributions to, equity holders acting in their capacity as equity holders.
71. The definitions of income and expenses identify their essential features but do not attempt to specify the criteria that would need to be met before they are recognised in the income statement. Criteria for the recognition of income and expenses are discussed in paragraphs 82 to 98.
72. Income and expenses may be presented in the income statement in different ways so as to provide information that is relevant for economic decision-making. For example, it is common practice to distinguish between those items of income and expenses that arise in the course of the ordinary activities of the entity and those that do not. This distinction is made on the basis that the source of an item is relevant in evaluating the ability of the entity to generate cash and cash equivalents in the future; for example, incidental activities such as the disposal of a long-term investment are unlikely to recur on a regular basis. When distinguishing between items in this way consideration needs to be given to the nature of the entity and its operations. Items that arise from the ordinary activities of one entity may be unusual in respect of another.
73. Distinguishing between items of income and expense and combining them in different ways also permits several measures of entity performance to be displayed. These have differing degrees of inclusiveness.

For example, the income statement could display gross margin (where retail activities are conducted), and results from providing major services before general administration expenses.

Income

74. The definition of income encompasses both revenue and gains.⁶ Revenue arises in the course of the ordinary activities of an entity and is referred to by a variety of different names including sales, fees, interest, dividends, royalties and rent.
75. Gains represent other items that meet the definition of income and may, or may not, arise in the course of the ordinary activities of an entity. Gains represent increases in economic benefits and as such are no different in nature from revenue. Hence, they are not regarded as constituting a separate element in this *PBE Framework*.
76. Gains include, for example, those arising on the disposal of non-current assets. The definition of income also includes unrealised gains; for example, those arising on the revaluation of marketable securities and those resulting from increases in the carrying amount of long term assets. When gains are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Gains are often reported net of related expenses.
77. Various kinds of assets may be received or enhanced by income; examples include cash, receivables and goods and services received in exchange for goods and services supplied. Income may also result from the settlement of liabilities. For example, an entity may provide goods and services to a lender in settlement of an obligation to repay an outstanding loan.

Expenses

78. The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity. Expenses that arise in the course of the ordinary activities of the entity include, for example, cost of sales, cost of services provided, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, property, plant and equipment.
79. Losses represent other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the entity. Losses represent decreases in economic benefits and as such they are no different in nature from other expenses. Hence, they are not regarded as a separate element in this *PBE Framework*.
80. Losses include, for example, those resulting from disasters such as fire and flood, as well as those arising on the disposal of non-current assets. The definition of expenses also includes unrealised losses, for example, those arising from the effects of increases in the rate of exchange for a foreign currency in respect of the borrowings of an entity in that currency. When losses are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for the purpose of making economic decisions. Losses are often reported net of related income.

Capital Maintenance Adjustments

81. The revaluation or restatement of assets and liabilities gives rise to increases or decreases in equity. While these increases or decreases meet the definition of income and expenses, they are not included in the income statement under certain concepts of capital maintenance. Instead these items are included in equity as capital maintenance adjustments or revaluation reserves. These concepts of capital maintenance are discussed in paragraphs 102 to 110 of this *PBE Framework*.

Recognition of the Elements of Financial Statements

82. Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition set out in paragraph 83. It involves the depiction of the item in words and by a monetary amount and the inclusion of that amount in the balance sheet or income statement totals. Items that satisfy the recognition criteria should be recognised in the balance sheet or income statement. The failure to recognise such items is not rectified by disclosure of the accounting policies used nor by notes or explanatory material.

⁶ Refer paragraph 47.1.

83. An item that meets the definition of an element should be recognised if:
- (a) It is probable that any future economic benefit or service potential associated with the item will flow to or from the entity; and
 - (b) The item has a cost or value that can be measured with reliability.
84. In assessing whether an item meets these criteria and therefore qualifies for recognition in the financial statements, regard needs to be given to the materiality considerations discussed in paragraphs 29 and 30. The interrelationship between the elements means that an item that meets the definition and recognition criteria for a particular element, for example, an asset, automatically requires the recognition of another element, for example, income or a liability.

The Probability of Future Economic Benefit or Service Potential

85. The concept of probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits or service potential associated with the item will flow to or from the entity. The concept is in keeping with the uncertainty that characterises the environment in which an entity operates. Assessments of the degree of uncertainty attaching to the flow of future economic benefits or service potential are made on the basis of the evidence available when the financial statements are prepared. For example, when it is probable that a receivable owed by an entity will be paid, it is then justifiable, in the absence of any evidence to the contrary, to recognise the receivable as an asset. For a large population of receivables, however, some degree of non-payment is normally considered probable; hence an expense representing the expected reduction in economic benefits is recognised.

Reliability of Measurement

86. The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability as discussed in paragraphs 31 to 38 of this *PBE Framework*. In many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When, however, a reasonable estimate cannot be made the item is not recognised in the balance sheet or income statement. For example, the expected proceeds from a lawsuit may meet the definitions of both an asset and income as well as the probability criterion for recognition; however, if it is not possible for the claim to be measured reliably, it should not be recognised as an asset or as income; the existence of the claim, however, would be disclosed in the notes, explanatory material or supplementary schedules.
87. An item that, at a particular point in time, fails to meet the recognition criteria in paragraph 83 may qualify for recognition at a later date as a result of subsequent circumstances or events.
88. An item that possesses the essential characteristics of an element but fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes, explanatory material or in supplementary schedules. This is appropriate when knowledge of the item is considered to be relevant to the evaluation of the financial position, performance and changes in financial position of an entity by the users of financial statements.

Recognition of Assets

89. An asset is recognised in the balance sheet when it is probable that the future economic benefits or service potential will flow to the entity and the asset has a cost or value that can be measured reliably.
90. An asset is not recognised in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the entity beyond the current accounting period. Instead such a transaction results in the recognition of an expense in the income statement. This treatment does not imply either that the intention of management in incurring expenditure was other than to generate future economic benefits or service potential for the entity or that management was misguided. The only implication is that the degree of certainty that economic benefits will flow to the entity beyond the current accounting period is insufficient to warrant the recognition of an asset.

Recognition of Liabilities

91. A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In practice, obligations under contracts that are

equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements. However, such obligations may meet the definition of liabilities and, provided the recognition criteria are met in the particular circumstances, may qualify for recognition. In such circumstances, recognition of liabilities entails recognition of related assets or expenses.

Recognition of Income

92. Income is recognised in the income statement when an increase in future economic benefits or service potential related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably. This means, in effect, that recognition of income occurs simultaneously with the recognition of increases in assets or decreases in liabilities (for example, the net increase in assets arising on a sale of goods or services or the decrease in liabilities arising from the waiver of a debt payable).
93. The procedures normally adopted in practice for recognising income, for example, the requirement that revenue should be earned, are applications of the recognition criteria in this *PBE Framework*. Such procedures are generally directed at restricting the recognition as income to those items that can be measured reliably and have a sufficient degree of certainty.

Recognition of Expenses

94. Expenses are recognised in the income statement when a decrease in future economic benefits or service potential related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably. This means, in effect, that recognition of expenses occurs simultaneously with the recognition of an increase in liabilities or a decrease in assets (for example, the accrual of employee entitlements or the depreciation of equipment).
95. Expenses are recognised in the income statement on the basis of a direct association between the costs incurred and the earning of specific items of income. This process, commonly referred to as the matching of costs with revenues, involves the simultaneous or combined recognition of revenues and expenses that result directly and jointly from the same transactions or other events; for example, the various components of expense making up the cost of goods sold are recognised at the same time as the income derived from the sale of the goods. However, the application of the matching concept under this *PBE Framework* does not allow the recognition of items in the balance sheet which do not meet the definition of assets or liabilities.
96. When economic benefits are expected to arise over several accounting periods and the association with income can only be broadly or indirectly determined, expenses are recognised in the income statement on the basis of systematic and rational allocation procedures. This is often necessary in recognising the expenses associated with the using up of assets such as property, plant, equipment, goodwill, patents and trademarks; in such cases the expense is referred to as depreciation or amortisation. These allocation procedures are intended to recognise expenses in the accounting periods in which the economic benefits associated with these items are consumed or expire.
97. An expense is recognised immediately in the income statement when an expenditure produces no future economic benefits or service potential or when, and to the extent that, future economic benefits or service potential do not qualify, or cease to qualify, for recognition in the balance sheet as an asset.
98. An expense is also recognised in the income statement in those cases when a liability is incurred without the recognition of an asset, as when a liability under a product warranty arises.

Measurement of the Elements of Financial Statements

99. Measurement is the process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement. This involves the selection of the particular basis of measurement.
100. A number of different measurement bases are employed to different degrees and in varying combinations in financial statements. They include the following:
 - (a) *Historical cost.* Assets are recorded at the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire them at the time of their acquisition. Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some

circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

- (b) *Current cost.* Assets are carried at the amount of cash or cash equivalents that would have to be paid if the same or an equivalent asset was acquired currently. Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.
 - (c) *Realisable (settlement) value.* Assets are carried at the amount of cash or cash equivalents that could currently be obtained by selling the asset in an orderly disposal. Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.
 - (d) *Present value.* Assets are carried at the present discounted value of the future net cash inflows that the item is expected to generate in the normal course of business. Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.
101. The measurement basis most commonly adopted by entities in preparing their financial statements is historical cost. This is usually combined with other measurement bases. For example, inventories are usually carried at the lower of cost and net realisable value, marketable securities may be carried at market value and pension liabilities are carried at their present value. Furthermore, some entities use the current cost basis as a response to the inability of the historical cost accounting model to deal with the effects of changing prices of non-monetary assets.

The Elements of Non-financial and Supplementary Information

101.1 The elements reported in non-financial and supplementary information and how these elements are defined will depend on a range of factors, including:

- (a) Legislative requirements; and
- (b) The entity's specific objectives, activities and accountability obligations.

101.2 For example, the elements of service performance are defined as inputs, outputs and outcomes.⁷

101.3 The quality of the information presented in non-financial and supplementary information should be considered with regard to the qualitative characteristics and constraints on those qualitative characteristics discussed in paragraphs 24 to 45 of this *PBE Framework*.

Concepts of Capital and Capital Maintenance

Concepts of Capital

102. A financial concept of capital is adopted by most entities in preparing their financial statements. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with the net assets or equity of the entity. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the entity based on, for example, units of output per day.
103. The selection of the appropriate concept of capital by an entity should be based on the needs of the users of its financial statements. Thus, a financial concept of capital should be adopted if the users of financial statements are primarily concerned with the maintenance of nominal invested capital or the purchasing power of invested capital. If, however, the main concern of users is with the operating capability of the entity, a physical concept of capital should be used. The concept chosen indicates the goal to be attained in determining surplus, even though there may be some measurement difficulties in making the concept operational.

⁷ Appendix C of PBE IPSAS 1 *Presentation of Financial Statements* provides guidance on service performance reporting.

Concepts of Capital Maintenance and the Determination of Surplus

104. The concepts of capital in paragraph 102 give rise to the following concepts of capital maintenance:
- (a) *Financial capital maintenance.* Under this concept a surplus is earned only if the financial (or money) amount of the net assets at the end of the period exceeds the financial (or money) amount of net assets at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period. Financial capital maintenance can be measured in either nominal monetary units or units of constant purchasing power.
 - (b) *Physical capital maintenance.* Under this concept a surplus is earned only if the physical productive capacity (or operating capability) of the entity (or the resources or funds needed to achieve that capacity) at the end of the period exceeds the physical productive capacity at the beginning of the period, after excluding any distributions to, and contributions from, owners during the period.
105. The concept of capital maintenance is concerned with how an entity defines the capital that it seeks to maintain. It provides the linkage between the concepts of capital and the concepts of surplus because it provides the point of reference by which surplus is measured; it is a prerequisite for distinguishing between an entity's return on capital and its return of capital; only inflows of assets in excess of amounts needed to maintain capital may be regarded as surplus and therefore as a return on capital. Hence, surplus is the residual amount that remains after expenses (including capital maintenance adjustments, where appropriate) have been deducted from income. If expenses exceed income the residual amount is a net loss.
106. The physical capital maintenance concept requires the adoption of the current cost basis of measurement. The financial capital maintenance concept, however, does not require the use of a particular basis of measurement. Selection of the basis under this concept is dependent on the type of financial capital that the entity is seeking to maintain.
107. The principal difference between the two concepts of capital maintenance is the treatment of the effects of changes in the prices of assets and liabilities of the entity. In general terms, an entity has maintained its capital if it has as much capital at the end of the period as it had at the beginning of the period. Any amount over and above that required to maintain the capital at the beginning of the period is surplus.
108. Under the concept of financial capital maintenance where capital is defined in terms of nominal monetary units, the surplus represents the increase in nominal money capital over the period. Thus, increases in the prices of assets held over the period, conventionally referred to as holding gains, are, conceptually, surpluses. They may not be recognised as such, however, until the assets are disposed of in an exchange transaction. When the concept of financial capital maintenance is defined in terms of constant purchasing power units, a surplus represents the increase in invested purchasing power over the period. Thus, only that part of the increase in the prices of assets that exceeds the increase in the general level of prices is regarded as a surplus. The rest of the increase is treated as a capital maintenance adjustment and, hence, as part of equity.
109. Under the concept of physical capital maintenance when capital is defined in terms of the physical productive capacity, a surplus represents the increase in that capital over the period. All price changes affecting the assets and liabilities of the entity are viewed as changes in the measurement of the physical productive capacity of the entity; hence, they are treated as capital maintenance adjustments that are part of equity and not as a surplus.
110. The selection of the measurement bases and concept of capital maintenance will determine the accounting model used in the preparation of the financial statements. Different accounting models exhibit different degrees of relevance and reliability and, as in other areas, management must seek a balance between relevance and reliability. This *PBE Framework* is applicable to a range of accounting models and provides guidance on preparing and presenting the financial statements constructed under the chosen model. At the present time, it is not the intention of the NZASB to prescribe a particular model other than in exceptional circumstances, such as for those entities reporting in the currency of a hyperinflationary economy. This intention will, however, be reviewed in the light of world developments.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the PBE Framework.

- BC1. This Basis for Conclusions provides background on matters considered by the New Zealand Accounting Standards Board (NZASB) in developing the Public Benefit Entities' *Framework* (PBE *Framework*) for application in by Tier 1 and Tier 2 public benefit entities. Where applicable, the language in the PBE *Framework* has been generalised for use by public benefit entities.
- BC2. The PBE *Framework* is based on the NZ *Framework*: Part B, which, in turn, is based on the IASB *Framework for the Preparation and Presentation of Financial Statements* (1989). The PBE *Framework* is a transitional framework, pending the development and issue of a conceptual framework by the International Public Sector Accounting Standards Board.
- BC3. As the PBE *Framework* is a transitional framework, the NZASB decided to make minimal changes to the text of the underlying IASB *Framework* (1989), relying on the process previously undertaken in initially adapting that *Framework* for application by public benefit entities. For example, the NZASB made further changes to align the PBE *Framework* with PBE Standards but did not change the titles of the individual statements or defined terms such as "income". The NZASB considered that this approach was also appropriate on the grounds that the PBE *Framework* does not override any financial reporting requirements in PBE Standards for public benefit entities.

Comparison with NZ *Framework*: Part B

The PBE *Framework* is drawn from the NZ *Framework*: Part B. There are no significant differences between the PBE *Framework* and the NZ *Framework*: Part B.

History of Amendments

The Public Benefit Entities' *Framework* was issued in May 2013.

This table lists the pronouncements establishing and substantially amending the PBE *Framework*. The table is based on amendments approved as at 28 February 2014.

Pronouncements	Date approved	Early operative date	Effective date (annual financial statements ... on or after ...)
Public Benefit Entities' <i>Framework</i>	May 2013	Early application not permitted	1 July 2014
<i>Omnibus Amendments—Legislative Update</i>	Feb 2014	Early application not permitted	1 July 2014

Table of Amended Paragraphs in PBE *Framework*

Paragraph affected	How affected	By ... [date]
Footnote to paragraph 8	Amended	<i>Omnibus Amendments—Legislative Update</i> [Feb 2014]
Footnote to paragraph 46	Amended	<i>Omnibus Amendments—Legislative Update</i> [Feb 2014]