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Ref: PSASB 1/1 Vol.1/ (36)

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Date: 15th January 2018

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IPSASB CONSULTATION PAPER: ACCOUNTING FOR REVENUE AND NON-EXCHANGE EXPENSES

The Public Sector Accounting Standards Board (PSASB) - Kenya was established by the Public Finance Management Act (PFM) No.18 of 24th July 2012. The Board was gazetted by the Cabinet Secretary, National Treasury on 28th February, 2014 and has been in operation since.

The Board is mandated to provide frameworks and set generally accepted standards for the development and management of accounting and financial systems by all state organs and Public entities in Kenya and to prescribe internal audit procedures which comply with the PFM Act, 2012.

The Public Sector Accounting Standards Board is pleased to submit its comments on the Consultation Paper (CP) **Accounting for Revenue and Non- Exchange Expenses** to the International Public Sector Accounting Standards Board. PSASB supports the work of IPSASB in providing guidelines for Revenue and Non- Exchange expenses. There is a gap in the current IPSASB literature on accounting for non- exchange expenditure which may lead to inconsistency in accounting for expenditure. PSASB finds these guidelines timely to address the gaps in the current IPSAS and the possible development of a new IPSAS(s).

PSASB responses on Specific Matters for Comment and the Preliminary Views are documented in the attachment for your consideration.

Regards,

BERNARD NDUNGU, MBS
CHAIRMAN, PUBLIC SECTOR ACCOUNTING STANDARDS BOARD



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Certified.

Accounting for Revenue and Non- Exchange Expenses: Responses to the Consultation Paper by Public Sector Accounting Standards Board- Kenya

Preliminary View 1

The IPSASB considers that it is appropriate to replace IPSAS 9, *Revenue from Exchange Transactions*, and IPSAS 11, *Construction Contracts* with an IPSAS primarily based on IFRS 15, *Revenue from Contracts with Customers*. Such an IPSAS will address Category C transactions that:

- a) Involve the delivery of promised goods or services to customers as defined in IFRS 15; and
- b) Arise from contract (or equivalent binding arrangement) with a customer which establishes performance obligations.

Do you agree with the IPSASB's Preliminary View 1? If not, please give your reasons

PSASB agrees that it is appropriate to replace IPSAS 9 and IPSAS 11 with an IPSAS primarily based on IFRS 15 to address Category C transactions. This will enhance convergence of IPSAS and IFRS where the nature of revenue transactions is similar.

Preliminary View 2

Because Category A revenue transactions do not contain any performance obligations or stipulations, the IPSASB considers that these transactions will need to be addressed in an updated IPSAS 23.

Do you agree with the IPSASB's Preliminary View 2? If not, please give your reasons.

PSASB agrees that Category A revenue transactions that do not contain any performance obligations or stipulations should be addressed in an updated IPSAS 23. While updating IPSAS 23 IPSASB should consider providing more guidelines on exchange and non-exchange transactions to enable preparers of the financial statements to make that distinction and therefore apply the relevant standard.

Specific Matter for Comment 1

Please provide details of the issues that you have encountered in applying IPSAS 23, together with an indication of the additional guidance you believe is needed in an updated IPSAS 23 for:

- a) Social contributions; and/ or
- b) Taxes with long collection periods

If you believe that there are other areas where IPSASB should consider providing additional guidance in an updated IPSAS 23, please identify these and provide details of the issues you have encountered, together with an indication of the additional guidance you believe is needed.

The current IPSAS 23 does not have guidelines on social contributions and taxes with long collection periods. PSASB opines that IPSASB should consider providing guidelines with relation to the two in addition to the existing guidance on taxes and transfers.

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Preliminary View 3

The IPSASB considers that Category B transactions should be accounted for using the Public Sector Performance Obligation Approach.

Do you agree with the IPSASB's Preliminary View 3? If not, please give your reasons.

PSASB agrees that Category B transactions should be accounted for using the PSPOA. The PSPOA is consistent with the IPSASB's Conceptual Framework, it's consistent with IPSAS and will resolve exchange and non- exchange determination which is difficult to determine for category B transactions.

Specific Matters for Comment 2

The IPSASB has proposed to broaden the requirements in the IFRS 15 five- step approach to facilitate applying a performance obligation approach to Category B transactions for the public sector. These five steps are as follows:

Step 1- Identify the binding arrangement (paragraphs 4.29-4.35);

Step 2- Identify the performance obligation (paragraphs 4.36-4.46);

Step 3- Determine the consideration (paragraphs 4.47-4.50);

Step 4- Allocate the consideration (paragraphs 4.51-4.54); and

Step 5- Recognize revenue (paragraphs 4.55-4.58).

Do you agree with the proposals on how each of the IFRS five steps could be broadened? If not, please explain your reasons.

PSASB agrees with the proposal on how each of the IFRS five steps could be broadened for Category B transactions for the public sector. In broadening the steps, IPSASB should consider giving more guidelines on step 1 and 2 because they largely determine the process and timing of revenue recognition and largely require the use of professional judgement.

Specific Matter for Comment 3

If the PSASB were to implement Approach 1 and update IPSAS 23 for category B transactions, which option do you favour for modifying IPSAS 23 for transactions with time requirements (but no other stipulations):

Option (b) ó Require enhanced display/ disclosure

Option (c) - Classify time requirements as a condition

Option (d) - Classify transfers with time requirements as other obligations; or

Option (e) - Recognise transfers with time requirements in net assets/equity and recycle through the statement of financial performance

Please explain your reasons.

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PSASB prefers option e- recognize transfers with time requirements in net assets/ equity and recycle through the statement of financial performance. This option is consistent with IPSASB conceptual framework; it's consistent with IPSAS and allows revenue to be recognized over one reporting period thereby enabling constituents to report more accurate information with regards to revenue transactions with time requirements.

Specific Matters for Comment 4

Do you consider that the option that you have identified in SMC 3 should be used in combination with Approach 1 Option (a) - Provide additional guidance on making the exchange/ non- exchange distinction?

- a) Yes
- b) No

Please explain your reasons

Yes. PSASB considers that Option e preferred in SMC 3 should be used in combination with Option (a) under Approach 1. Although the combination of these options would not fully resolve the exchange/non- exchange transaction distinction, it would enhance the existing guidance to preparers on the distinction which currently poses a challenge under the existing IPSAS 23.

Preliminary View 4

The IPSASB considers that accounting for capital grants should be explicitly addressed within IPSAS.

Do you agree with the IPSASB's Preliminary View 4? If not, please give your reasons.

PSASB agrees that accounting for capital grants should be explicitly addressed within IPSAS.

Specific Matters for Comment 5

a) Has IPSASB identified the main issues with capital grants? If you think that there are other issues with capital grants please identify them.

b) Do you have any proposals for accounting for capital grants that the IPSASB should consider? Please explain your issues and proposals.

a) IPSASB has identified the main issues with capital grants especially in relation to capital grants with conditions. However, PSASB opines that there are challenges with capital grants that have restrictions which may not have been identified. For example, in Kenya, the National Government transfers capital grants to Universities for construction of facilities. These grants are not required to be returned to the transferor and therefore are recognized as revenue when they become receivable or when received whichever comes earlier. In some cases, the National Government transfers the full amount relating to a capital project in the year in which the project has been budgeted for. The University then recognizes the full

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amount as revenue since the stipulation on the resource is a restriction and no liability is recognized for the same. This in effect causes the University/ Entity to which transfers are made to record a significant amount of surplus in the year the grant is recognized. The alternative would be to recognize a liability and then recognize income as the capital project is being constructed over time.

b) PSASB has the following proposals for accounting for capital grants that the IPSASB should consider:

IPSASB should consider extending the stipulation on conditions to not only refund of funds to the transferor but other sanctions such as legislation, cabinet or ministerial decisions and reduction of future funding of the program. This will enable more resources to be recognized as liabilities where there is an obligation and will resolve some of the issues with restricted capital grants as noted above.

For capital grants with conditions, IPSASB should consider a similar application with that under IAS 20 Government Grants and Disclosure of Government Assistance. This will enable preparers to recognize revenue on a systematic basis over the life of the asset.

Specific Matter for Comment 6

Do you consider that IPSASB should:

- a) Retain the existing requirements for services in kind, which permit, but do not require recognition of services in kind; or
- b) Modify requirements to require services in kind that meet the definition of an asset, to be recognised in the financial statements provided that they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information; or
- c) An alternative approach

Please explain your reasons. If you favour an alternative approach, please identify that approach and explain it.

IPSASB should modify requirements to require services in kind that meet the definition of an asset, to be recognized in the financial statements provided that they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information. This will enhance comparability of financial statements and where these services in kind are significant, the information will be beneficial to users of the financial statements in determining the value of services in kind provided to an entity.

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Preliminary View 5

The IPSASB is of the view that non- exchange transactions related to universally accessible services and collective services impose no performance obligations on the resource recipient. These non- exchange transactions should therefore be accounted for under the Extended Obligating Event Approach

Do you agree with the IPSASB's Preliminary View 5? If not, please give your reasons.

The PSASB agrees with this preliminary view.

Preliminary View 6

The IPSASB is of the view that, because there is no obligating event related to non- exchange transactions for universally accessible services and collective services, resources applied for these types of non- exchange transactions should be expensed as services are delivered.

Do you agree with the IPSASB's Preliminary View 6? If not, please give your reasons.

The PSASB agrees with this preliminary view.

Preliminary View 7

The IPSASB is of the view that where grants, contributions and other transfers contain either performance obligations or stipulations, they should be accounted for using the PSPOA which is the counterpart to the IPSASB's preferred approach for revenue.

Do you agree with the IPSASB's Preliminary View 7? If not, please give your reasons

PSASB agrees that where grants, contributions and other transfers contain either performance obligations or stipulations, they should be accounted for using the PSPOA. This will enhance uniformity while recognizing revenue and expenses for the resources recipient and the resources provider respectively.

Preliminary View 8

The Board considers that at initial recognition, non- contractual receivables should be measured at face value (legislated amount) of the transaction(s) with any amount expected to be collectible identified as an impairment.

Do you agree with the IPSASB's Preliminary View 8? If not, please give your reasons.

PSASB agrees that at initial recognition, non contractual receivables should be measured at face value. By using this measurement, it will be easier to assess the receivables for impairment on a regular basis as opposed to using the discounted cash flows method. In addition, the face value or legislated amount will enhance transparency and accountability by entities in collecting all their receivables including those that may be considered impaired from time to time.

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Preliminary View 9

The IPSASB considers that subsequent of non- contractual receivables should use the fair value approach.

Do you agree with the IPSASB's Preliminary View 9? If not, please give your reasons.

PSASB disagrees with this Preliminary View and opines that use of the cost approach would be more ideal for non- contractual receivables. While using fair value, it would be difficult to determine the market rate for non- contractual receivables this would not therefore resolve the existing measurement gaps for non- contractual receivables. On the other hand however, using the cost approach resolves the complexities involved with determining a market rate and is consistent with the initial measurement at face value covered under Preliminary View 8.

Specific Matter for Comment 7

For subsequent measurement of non- contractual payables do you support:

- a) Cost of Fulfillment Approach
- b) Amortized Cost Approach
- c) Hybrid Approach
- d) IPSAS 19 requirements

Please explain your reasons.

For subsequent measurement of non- contractual payables, PSASB supports the Cost of Fulfillment Approach. This approach is easy to apply and produces understandable information to users of financial statements.