

28 October 2020

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Submitted to: www.ifac.org

Dear Ross

Revenue and Transfer Expenses

Thank you for the opportunity to comment on the IPSASB's proposals in relation to revenue and transfer expenses. This letter sets out our comments on the following exposure drafts (EDs).

- ED 70 *Revenue with Performance Obligations*
- ED 71 *Revenue without Performance Obligations*
- ED 72 *Transfer Expenses*

As the EDs have been exposed for comment in New Zealand, some New Zealand constituents may comment directly to you.

We acknowledge the work and effort that the IPSASB has put into developing these important EDs. This cover letter contains some general comments on the EDs and highlights some matters that are discussed in more detail in our responses to the Specific Matters for Comment (SMCs).

ED 70 Revenue with Performance Obligations

We support the IPSASB developing a standard based on IFRS 15 *Revenue from Contracts with Customers* and most of the proposals in ED 70. We appreciate the work undertaken by the IPSASB to modify and supplement the requirements in IFRS 15 to make it appropriate for application in the public sector. Extending the scope of the proposed standard to include the delivery of goods and services to third-party beneficiaries clarifies the accounting for revenue from these types of transactions which are prevalent in the public sector.

ED 71 Revenue without Performance Obligations

We have both conceptual and practical concerns with the proposals in ED 71.

From a conceptual perspective we disagree with the IPSASB's conclusion that, in the absence of a performance obligation, an entity's obligations arising from binding arrangements represent an outflow of resources as discussed in the Conceptual Framework. We are also concerned about the implications of the proposals in ED 71 for the existing understanding of when liabilities should be recognised.

From a practical perspective we are concerned that the proposals in ED 71 would require new and subjective judgements compared to the judgements required in applying IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. We do not believe it is helpful to move from one set of arguments (about IPSAS 23 requirements) to a new set of arguments (about ED 71 requirements).

Our response to SMC 1 expands upon these points and concludes by looking at possible ways forward, one of which would be to mount arguments for the deferral of revenue based on user needs.

ED 72 Transfer Expenses

In general we support the recognition and measurement proposals in ED 72, including the lack of symmetry with ED 71. As outlined in our detailed responses, there are a number of areas where we consider that the proposals need further work.

As previously noted in our comments about social benefits and collective and individual services, we would have preferred that the IPSASB address non-exchange expenses in a single project to ensure consistent requirements for transactions with similar characteristics.

Other comments

Complexity

We have a general concern about the ability of preparers and auditors to understand and consistently apply the proposed requirements in ED 71 and ED 72. Although all three EDs are long and complex, in the case of ED 70 we consider that the benefits of alignment with IFRS 15 make this an acceptable trade-off.

We have found some parts of ED 71 and ED 72 difficult to understand and have also received feedback from constituents to this effect. Constituents have found the terminology difficult, particularly the distinction between performance obligations and present obligations without performance obligations.

We think that ED 71 and ED 72 need further work to ensure that the requirements are expressed as clearly as possible, both to aid understanding and to lead to consistent application.

Interaction between the EDs and IPSAS 19

The interaction between the EDs and IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* is not clear. We are particularly concerned about the interaction between ED 72 and IPSAS 19 which, in the absence of a standard on transfer expenses, has been a source of guidance for transfer expenses and the associated liabilities.

Disclosures

We agree with the disclosure proposals in ED 70. We disagree with the disclosure proposals in ED 71 and ED 72 and consider that they are excessive. Our responses to the SMCs elaborate on this view.

Our responses to the Specific Matters for Comment are set out in the Appendices to this letter. If you have any queries or require clarification of any matters in this letter, please contact Joanne Scott (joanne.scott@xrb.govt.nz) or me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Michael Bradbury', with a stylized flourish at the end.

Michael Bradbury
Acting Chair – New Zealand Accounting Standards Board

APPENDIX 1 Response to SMCs on ED 70 Revenue with Performance Obligations**ED 70 Specific Matter for Comment 1**

This Exposure Draft is based on IFRS 15, *Revenue from Contracts with Customers*. Because in some jurisdictions public sector entities may not have the power to enter into legal contracts, the IPSASB decided that the scope of this Exposure Draft would be based around binding arrangements. Binding arrangements have been defined as conferring both enforceable rights and obligations on both parties to the arrangement.

Do you agree that the scope of this Exposure Draft is clear? If not, what changes to the scope of the Exposure Draft or the definition of binding arrangements would you make?

We generally agree with the scope of the ED. Extending the scope of the proposed standard to include the delivery of goods and services to third-party beneficiaries clarifies the accounting for revenue from these types of transactions which are prevalent in the public sector.

However, there are two aspects that we would like clarified.

Interaction with IPSAS 19

The relationship between this ED and IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* needs to be clarified. Based on our reading of the ED, it appears that the IPSASB's intention was to establish linkages equivalent to those between IFRS 15 *Revenue from Contracts with Customers* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.¹ However, there is a conflict between ED 70 paragraph 3(e), which excludes rights and obligations arising from binding arrangements within the scope of IPSAS 19, and the proposed amendment to IPSAS 19 paragraph 13(c) which states that IPSAS 19 applies to binding arrangements with purchasers that are, or have become, onerous. We agree with the proposed amendments to IPSAS 19 paragraph 13(c) (which are equivalent to IAS 37 paragraph 5(g)), but not with the reference to IPSAS 19 in ED 70 paragraph 3(c). The scope of IFRS 15 does not exclude transactions within the scope of IAS 37.

Relevant extracts from ED 70 are shown below.

Extracts from ED 70**Scope**

3. An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this [draft] Standard in accounting for revenue arising from binding arrangements with a purchaser that include performance obligations as defined in this [draft] Standard to transfer promised goods or services to the purchaser or third-party beneficiary. This [draft] Standard does not apply to:
 - ...
 - (e) Rights or obligations arising from binding arrangements within the scope of, IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, IPSAS 32, *Service Concession Arrangements: Grantor*, IPSAS 34, *Separate Financial Statements*, IPSAS 35, *Consolidated Financial Statements*, IPSAS 36, *Investments in Associates and Joint Ventures*, IPSAS 37, *Joint Arrangements*, IPSAS 39, *Employee Benefits* and IPSAS 40, *Public Sector Combinations*;
 - ...

¹ This statement is based on the fact that ED 70 (i) contains equivalent guidance to that in IFRS 15 on service type warranties, assurance type warranties and compensation for damages and (ii) does not contain any explicit guidance on onerous contracts.

AG23. A statement of intent or public announcement by a purchaser (e.g. government) to spend money or deliver goods and services in a certain way is not an enforceable arrangement for the purposes of this [draft] Standard. Such a declaration is general in nature and does not create a binding arrangement between a purchaser and an entity (resource recipient). An entity would need to consider whether such a public announcement gives rise to a non-legally binding (constructive obligation) under IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

**Extracts from IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*
(as proposed to be amended by ED 70)**

Other Exclusions from the Scope of the Standard

...

13. Where another IPSAS deals with a specific type of provision, contingent liability, or contingent asset, an entity applies that standard instead of this Standard. For example, certain types of provisions are also addressed in Standards on:
- (a) ~~Construction contracts (see IPSAS 11, *Construction Contracts*); and [Deleted]~~
 - (b) ...; and
 - (c) Revenue from binding arrangements with purchasers (see [draft] IPSAS [X] (ED 70), *Revenue with Performance Obligations*). However, as [draft] IPSAS [X] (ED 70) contains no specific requirements to address binding arrangements with purchasers that are, or have become, onerous, this [draft] Standard applies to such cases.

...

15. Some amounts treated as provisions may relate to the recognition of revenue, for example where an entity gives guarantees in exchange for a fee. This Standard does not address the recognition of revenue. ~~IPSAS 9, *Revenue from Exchange Transactions*~~[draft] IPSAS [X] (ED 70) identifies the circumstances in which revenue from exchange transactions arising from binding arrangements with a purchaser that include performance obligations to transfer promised goods or services to the purchaser or third-party beneficiary is recognized, and provides practical guidance on the application of the recognition criteria. This Standard does not change the requirements of ~~IPSAS 9~~ [draft] IPSAS [X] (ED 70).

Financial instruments

The links between the scope of ED 70, ED 71 and IPSAS 41 *Financial Instruments* also need to be clarified. Please refer to our comments on ED 71 SMC 5 about the subsequent measurement of receivables and binding arrangement assets.

ED 70 Specific Matter for Comment 2

This Exposure Draft has been developed along with [draft] IPSAS [X] (ED 71), *Revenue without Performance Obligations*, and [draft] IPSAS [X] (ED 72), *Transfer Expenses*, because there is an interaction between them. Although there is an interaction between the three Exposure Drafts, the IPSASB decided that even though ED 72 defines transfer expense, ED 70 did not need to define “transfer revenue” or “transfer revenue with performance obligations” to clarify the mirroring relationship between the exposure drafts. The rationale for this decision is set out in paragraphs BC20–BC22.

Do you agree with the IPSASB’s decision not to define “transfer revenue” or “transfer revenue with performance obligations”? If not, why not?

We agree with the IPSASB’s decision not to define ‘transfer revenue’ or ‘transfer revenue with performance obligations’.

ED 70 Specific Matter for Comment 3

Because the IPSASB decided to develop two revenue standards—this Exposure Draft on revenue with performance obligations and ED 71 on revenue without performance obligations—the IPSASB decided to provide guidance about accounting for transactions with components relating to both exposure drafts. The application guidance is set out in paragraphs AG69 and AG70.

Do you agree with the application guidance? If not, why not?

We agree with the application guidance in paragraphs AG60 and AG70.

We note that paragraph 9 of ED 71 refers to ED 70 where transactions include components with performance obligations and components without performance obligations. A similar paragraph should be included in ED 70 to refer entities to ED 71 for transactions with components with performance obligations and components without performance obligations. At the moment there is no reference to such transactions in the body of ED 70. Rather, the reference is in the application guidance.

AASB 15 *Revenue from Contracts with Customers* contains an appendix, Australian implementation guidance for not-for-profit entities. Paragraph F30 requires an entity to assess whether the component of the transaction price not related to the performance obligation is material and needs to be accounted for separately. Paragraph F30 is shown below.

F30 Where the presumption is rebutted, the entity shall disaggregate the transaction price and account for the component that relates to the transfer of promised goods or services in accordance with this Standard. The remainder of the transaction price shall be accounted for in accordance with AASB 1058. Whether the element not related to the performance obligation is material, and therefore needs to be accounted for separately, shall be assessed in relation to the individual contract, without reassessment at an aggregate or portfolio level.

We think this paragraph is helpful and should be included in the application guidance in ED 70. Entities could then avoid unnecessary discussions and undue costs if they did not have to separate and account separately for the immaterial components of a transaction.

ED 70 Specific Matter for Comment 4

The IPSASB decided that this Exposure Draft should include the disclosure requirements that were in IFRS 15. However, the IPSASB acknowledged that those requirements are greater than existing revenue standards.

Do you agree that the disclosure requirements should be aligned with those in IFRS 15, and that no disclosure requirements should be removed? If not, why not?

We agree that the disclosure requirements in ED 70 should be aligned with those in IFRS 15.

ED 70 Specific Matter for Comment 5

In developing this Exposure Draft, the IPSASB noted that some public sector entities may be compelled to enter into binding arrangements to provide goods or services to parties who do not have the ability or intention to pay. As a result, the IPSASB decided to add a disclosure requirement about such transactions in paragraph 120. The rationale for this decision is set out in paragraphs BC38–BC47.

Do you agree with the decision to add the disclosure requirement in paragraph 120 for disclosure of information on transactions which an entity is compelled to enter into by legislation or other governmental policy decisions? If not, why not?

We agree with the additional disclosures proposed in paragraph 120 of ED 70.

ED 70 Other comments

Receivables and binding arrangement assets

The proposed requirements for receivables and binding arrangement assets in ED 70 and ED 71 need to be clarified. Please see our comments on ED 71 SMC 5 about the subsequent measurement of receivables and binding arrangement assets.

Paragraphs ED 70.32 and IFRS 15.33 – consistency

In comparing ED 70 with IFRS 15 we noticed a difference between the wording in paragraphs 32 and 33 respectively. The paragraphs relate to the sections of the standards dealing with the satisfaction of performance obligations. The shaded words are not included ED 70.32.

Goods and services are assets, even if only momentarily, when they are received and used (as in the case of many services). Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. The benefits of an asset are the potential cash flows (inflows or savings in outflows) that can be obtained directly or indirectly in many ways, such as by:

....

A similar paragraph is included in ED 72 (see paragraph 35).

ED 70 defines the term 'control of an asset' and we think it would be helpful to include the shaded wording in IFRS 15.33 in ED 70.32. As ED 70 is based on IFRS 15 it is not clear why the shaded wording in IFRS 15 was not included in ED 70.

APPENDIX 2 Response to SMCs on ED 71 *Revenue without Performance Obligations*

ED 71 Specific Matter for Comment 1 (Paragraphs 14–21)

The ED proposes that a present obligation is a binding obligation (legally or by equivalent means), which an entity has little or no realistic alternative to avoid and which results in an outflow of resources. The IPSASB decided that to help ascertain whether a transfer recipient has a present obligation, consideration is given to whether the transfer recipient has an obligation to perform a specified activity or incur eligible expenditure.

Do you agree with the IPSASB's proposals that for the purposes of this [draft] Standard, *Revenue without Performance Obligations*, a specified activity and eligible expenditure give rise to present obligations? Are there other examples of present obligations that would be useful to include in the [draft] Standard?

We do not agree with the IPSASB's proposals, as outlined in SMC 1. We have both conceptual and practical concerns with the proposals in ED 71.

We acknowledge that this is a challenging topic for the IPSASB to address. At the end of the response to this SMC, we have identified two options for the IPSASB to consider in moving this project forward, both of which would require careful consideration of the costs (to preparers of meeting the requirements) and benefits (to users of the information reported under those requirements). We are willing to be engaged in further discussions if the IPSASB decides to consider either of these options.

Concerns with the proposals

We disagree with the IPSASB's conceptual analysis of why, in the absence of a performance obligation, an entity may have a liability in relation to obligations to carry out specified activities or incur eligible expenditure. We therefore disagree with the IPSASB's conclusion that, in the absence of a performance obligation, an entity's obligations arising from binding arrangements represent an outflow of resources as discussed in the Conceptual Framework. We are also concerned about the implications of the proposals in ED 71 for the existing understanding of when liabilities should be recognised.

We have reflected on our support for the proposals in ED 70 compared to our lack of support for the proposals in ED 71. In our view the principle in ED 70 (IFRS 15 *Revenue from Contracts with Customers*) is clear: a performance obligation is a promise to transfer goods or services to the purchaser or third party-beneficiary and revenue is recognised as control of goods and services is transferred. This principle is well informed by the extensive IFRS 15 guidance available and we acknowledge the work the IPSASB has done in considering the application of the IFRS 15 requirements in a public sector setting. By contrast, we do not think that there is a clear principle in ED 71, and we do not think there is sufficient guidance to lead to consistent application of the requirements. We envisage preparers encountering significant implementation issues as they try to determine the line between enforceable eligible expenditure and specified activities that lead to present obligations (per the ED) and those that do not.

From a practical perspective we are concerned that the proposals in ED 71 would require new and subjective judgements compared to the judgements required in applying IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. Revenue recognition (and deferral) is the subject of frequent debate in New Zealand. Entities often receive large portions of funding in advance of the period in which they expect to incur the related expenses. This is because (i) multi-year grants are

common and (ii) the balance dates of funders and recipients, and funding cycles and reporting periods often differ. This leads to discussions about the period in which revenue should be recognised. It also leads to situations where entities must recognise large amounts of revenue upon receipt. Any new revenue recognition requirements should give clear answers and lead to consistent outcomes. It is not helpful for users if different entities make subjective judgement calls with different outcomes for transactions and events that are substantively similar. Nor is it helpful for preparers and auditors to debate what requirements mean and how they apply to particular transactions. As a standard setter, this is not a desirable scenario. We do not believe it is helpful to move from one set of arguments (about IPSAS 23 requirements) to a new set of arguments (about ED 71 requirements).

This response expands upon these points and concludes by looking at possible ways forward, one of which would be to mount arguments for the deferral of revenue based on user needs.

Outflow of resources

We encourage the IPSASB to reconsider whether the ideas in the Conceptual Framework have been applied consistently in the ED.

The Conceptual Framework (paragraph 5.15) states that obligations are not present obligations unless they are binding *and* there is little or no realistic alternative to avoid an outflow of resources. ED 71 appears to consider these two aspects of present obligations separately. We are concerned that focusing on particular phrases from the Conceptual Framework without considering statements in their entirety could inadvertently change their meaning.

The Conceptual Framework (paragraph 5.16) also states a liability must involve an *outflow of resources* from the entity. Although the Conceptual Framework does not elaborate on what is meant by an outflow of resources, we are of the view that such outflows must be to parties external to the entity and result in a reduction in the entity's net assets. We do not agree that an obligation arising from a binding arrangement to perform a specified activity or incur eligible expenditure (for example, the acquisition of capital assets, employee services, or payments to suppliers for goods or services)-results in an outflow of resources that reduces the entity's net assets. There is no obligation for a direct outflow of resources to an external party as would be the case if the binding arrangement required the entity to transfer specific goods or services to the resource provider or a third party beneficiary (i.e. transactions within the scope of ED 70). An obligation to spend the funds on performing a specified activity or incurring eligible expenditure as described in ED 71 does not result in a reduction in the entity's net assets because the use of those transferred resources is controlled by the recipient entity and the entity uses those resources in exchange for other goods and services.

More general implications for liability recognition

ED 71 brings in new ideas and terms that could lead to the recognition of liabilities in circumstances where liabilities would not currently be recognised or where entities might have applied IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. Although ED 71 is a revenue standard, we are concerned about the potential implications of a new set of requirements (with a different view of what is meant by an outflow of resources) for more general discussions about the recognition of

liabilities. In the absence of a general standard on liabilities, IPSAS 19 is the main point of reference for liability discussions. Unless the requirements and guidance in ED 71 and IPSAS 19 are consistent, the circumstances in which ED 71 requires the recognition of liabilities would need to be tightly circumscribed. Otherwise there is a risk that people will look to two different sets of requirements to justify the recognition of liabilities.

Looking at the flowchart in SMC 2 also prompted us to consider the interaction between ED 71 and IPSAS 19 in more detail. See SMC 2 for further comments.

Need for clear requirements

IPSAS 23 currently requires deferral of revenue in certain non-exchange transactions. As noted in the Basis for Conclusions on ED 71 (paragraph BC5) constituents applying IPSAS 23 have experienced difficulties in distinguishing between exchange and non-exchange transactions and between conditions and restrictions. We are concerned that the current issues associated with IPSAS 23 might be replaced with a new set of problems (distinguishing between binding arrangements with performance obligations, binding arrangements without performance obligations but with present obligations, and arrangements that are not binding) but without commensurate improvements for users of financial statements.

To illustrate this, we have identified some issues associated with ED 71.

- *To defer or not:* We have found it difficult to distinguish between situations in which revenue can and cannot be deferred under ED 71. This is partly because of a lack of clarity around what qualifies as a 'specified activity' or 'eligible expenditure'. For example, we have considered how the ED would apply to a two-year grant, made as part of a binding arrangement, paid up front (i) for general operational expenses and (ii) for the salary of an employee and certain other expenses. Our understanding of ED 71 and the IPSASB's intentions is that the grant for the salary and certain other expenses could be eligible expenditure and recognised over time,² but that the grant for operational spending would be a transfer without a present obligation and would be recognised immediately. If one thinks of these two examples as being examples of grants that range from less specific to more specific, we do not think that ED 71 establishes a clear cut off point between what would qualify as eligible expenditure and what would not. To avoid unhelpful debates clearer boundaries are required.
- *Specified activities versus eligible expenditure:* We have also found it difficult to distinguish between specified activities and eligible expenditure. For example, the ED 71 At-A-Glance document refers to the purchase of hospital beds as an example of a specified activity. We think that this could equally be used as an example of incurring eligible expenditure – the money must be spent on the beds. Similarly, we were not sure whether some of the illustrative examples that accompany ED 71 were intended to illustrate specified activities or eligible expenditure. If the distinction between the two is kept, we recommend that the illustrative examples state which type of present obligation exists.

² ED 71 paragraph AG25 gives the example of a salary for marketing manager, travel expenditure and promotional material when discussing eligible expenditure.

As the distinction between specified activities and eligible expenditure does not affect the proposed accounting, we would prefer that the IPSASB did not make this distinction.

As mentioned above, we think there needs to be a clear principle and guidance about the cut-off point between revenue that can and cannot be deferred. The clearest way to do this might be to require that there be an enforceable obligation to spend the resources in the manner specified by the transfer provider, with that obligation being *sufficiently specific to demonstrate that enforceability exists*. Subsequently, the focus on sufficient specificity would help an entity demonstrate that it has satisfied the obligations. Obligations that relate solely to spending funds in a particular period (time requirements) and open-ended obligations without a specified cut-off date for satisfaction would not be enforceable. The focus of the requirements and associated guidance would then be on whether a binding arrangement has the critical characteristics required to defer revenue in line with the enforceable obligations.

Enforceability – substance

Paragraphs 22 to 26 of ED 71 discuss enforceability and paragraph 24 states that “If past experience or knowledge indicates that the transfer provider never enforces an arrangement if a breach occurs, then the transfer recipient may conclude that the arrangement is not enforceable in substance.” We think it is appropriate for the ED to draw attention to the fact that it is necessary to consider whether an arrangement is enforceable in substance and support the use of the word ‘may’ in paragraph 24. However, we caution against implying that any agreement that has not previously been enforced is not enforceable in substance (as in illustrative example 24).

Enforceability – incurring some other form of penalty

ED 71 refers in a few places to an entity repaying or returning resources to the transfer provider or incurring *some other form of penalty*. We received feedback from constituents that they did not understand what this phrase was trying to convey. Our understanding is that it is intended to cover both the possibility of having to pay a penalty for a breach of an agreement or being required (via a legal process) to perform the agreed actions. As drafted, we do not think that this is sufficiently clear.

The way forward

As outlined above, we disagree with the IPSASB’s conceptual arguments for the proposals in ED 71. We acknowledge that this is a challenging area where it is necessary to consider both conceptual arguments and user needs. We see two possible ways forward, both of which would require careful consideration and further consultation.

One option would be to align more closely with the definition of a liability and an outflow of resources in the Conceptual Framework. This would result in more upfront recognition of revenue. Entities could then explain (via presentation and disclosure) how revenue recognised in the current period relates to activities to be conducted in future periods. Presentation and disclosure remain important tools for entities regardless of whether the IPSASB proceeds with the proposals in ED 71 or not. There will always be some upfront funding which relates to ongoing activities and which will be recognised as revenue upon receipt.

Another option would be to develop a rationale for the deferral of revenue based on users' needs (and to explore the use of 'other obligations', as envisaged by the IPSASB's Conceptual Framework). We note that users' desire for information about cash flows that relate to the current period, as opposed to cash flows that relate to future periods, was the subject of much debate during the development of the Conceptual Framework (as documented in the Basis for Conclusions, paragraphs BC5.43 to BC5.56). These debates led to the IPSASB deciding not to define deferred inflows and outflows as elements, and to accept that certain economic phenomena that do not meet the definition of any element may need to be recognised in financial statements in order to meet the objectives of financial reporting. The revenue transactions that led to these earlier debates continue to be the types of transactions where we have concerns about the proposals in ED 71.

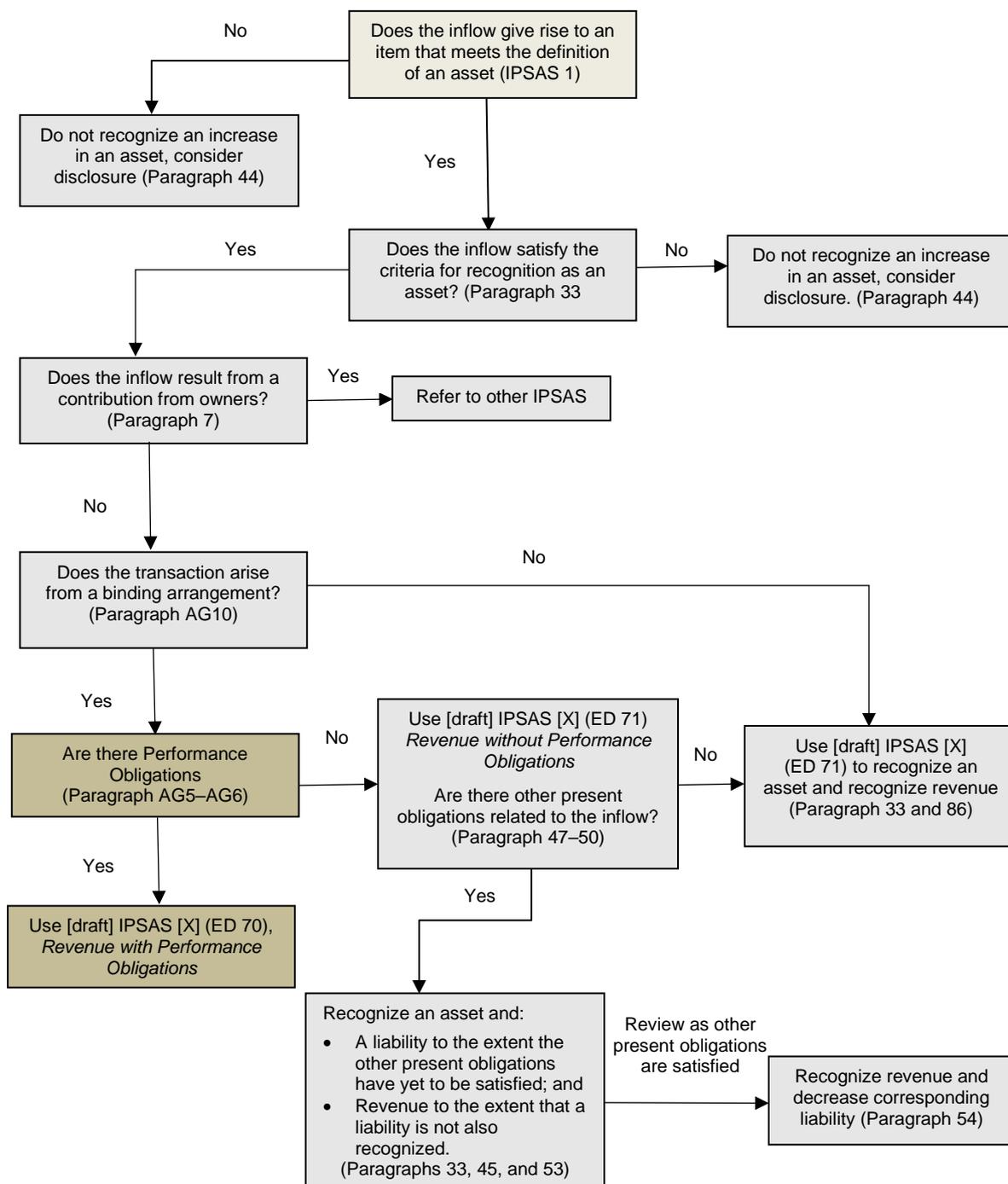
Transactions that fall within the scope of ED 71 differ in nature from those that fall within the scope of ED 70: they are more likely to be large, involve upfront payment and be paid less frequently. We acknowledge that upfront revenue recognition for transactions with these characteristics can make it difficult for users to form views about an entity's financial performance. We would be open to the IPSASB mounting arguments for the deferral of revenue based on user needs. If the IPSASB takes this route, the circumstances under which deferral is permitted would need to be clearly specified. This option would also have implications for presentation – only those items that are liabilities should be presented as such.

As noted above, either of these ways forward would require further consideration and consultation.

ED 71 Specific Matter for Comment 2 (Paragraph 31)

The flowchart that follows paragraph 31 of this [draft] Standard illustrates the process a transfer recipient undertakes to determine whether revenue arises and, if so, the relevant paragraphs to apply for such revenue recognition. Do you agree that the flowchart clearly illustrates the process? If not, what clarification is necessary?

Diagram 2: Flowchart from ED 71



* The flowchart is illustrative only. It does not take place of this [draft] Standard and is provided as an aid to interpreting this [draft] Standard.

* In certain circumstances, such as when a creditor forgives a liability, a decrease in the carrying amount of a previously recognized liability may arise. In these cases, instead of recognizing an asset, the entity decreases the carrying amount of the liability.

* In determining whether the entity has satisfied all of the present obligations, the application of the definitions of specified activity or eligible expenditure, and the criteria for recognizing a liability, are considered.

Other SMCs outline our views on the proposals in the ED. This response begins by commenting on the flowchart and then makes some additional comments about the interaction of ED 71 and IPSAS 19, prompted by looking at the flowchart.

Comments on flowchart

We agree that the flowchart depicts most of the proposals in the ED. However, we do not think it accurately depicts the scope of the ED because it starts with assets, rather than *assets that fall within the scope of the ED*. The flowchart illustrates that contributions from owners are outside the scope of the ED, but apart from contributions from owners it does not address other transactions, such as provisions, that are outside the scope of the ED. This comment could be addressed by reworking the flowchart. However, it prompted us to consider how an entity applying ED 71 would decide when it should also apply IPSAS 19.³

We found this exercise quite difficult and consider that the interaction between the two standards needs to be clearer. We have outlined how we think an entity would work through these steps.

Interaction with IPSAS 19

ED 71 paragraph 3(h) says that ED 71 does not apply to rights or obligations arising from binding arrangements within the scope of IPSAS 19. An entity will apply ED 71 because it has a revenue transaction. It will then consider whether it is required to recognise liabilities in accordance with ED 71 or any liabilities in accordance with other standards.

Taking constructive obligations as an example, an entity that has revenue from a transaction without performance obligations (but which is a binding arrangement) would consider whether it has to recognise a liability for present obligations to carry out specified activities or incur eligible expenses. Assuming the answer is no, the entity might then seek to argue that it has a constructive obligation to spend the funds as required. It is not clear what the scope exclusion in ED 71 paragraph 3(h) means. Does it mean that once an entity has decided it has revenue that falls within the scope of ED 71 it cannot also apply IPSAS 19 when considering whether it has a constructive obligation? Or does it mean that an entity first applies ED 71 and then considers whether it has a constructive obligation under IPSAS 19?

Similar questions might arise for an entity applying ED 71 to an arrangement *that is not binding*. The scope exclusion in paragraph 3(h) refers only to rights or obligations arising from *binding arrangements*.

We found one mention of constructive obligations in ED 71 (in paragraph AG23) which discusses whether transfer recipients can rely on public announcements about funding. It says that an entity considers whether the transfer provider has a constructive obligation. Example 32 in ED 71, which discusses contingent assets, would suggest that an entity is required to apply IPSAS 19.

³ We have recommended that the scope of ED 70 be aligned with the scope of IFRS 15 in relation to onerous contracts. That comment was made in the context of ED 70 and alignment with IFRS 15. We have considered ED 71 separately.

Regardless of how this interaction between IPSAS 19 and ED 71 is addressed, we think entities need more guidance in ED 71 about whether or not they are required to apply, or are prohibited from applying, the requirements in IPSAS 19.

Relevant extracts from ED 71 follow.

Extracts from ED 71

Scope

3. **A transfer recipient that prepares and presents financial statements under the accrual basis of accounting shall apply this [draft] Standard in accounting for revenue from transactions without performance obligations. This [draft] Standard does not apply to:**

...

- (h) **Rights or obligations arising from binding arrangements within the scope of, IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets, IPSAS 32, Service Concession Arrangements: Grantor, IPSAS 34, Separate Financial Statements, IPSAS 35, Consolidated Financial Statements, IPSAS 36, Investments in Associates and Joint Ventures, IPSAS 37, Joint Arrangements, IPSAS 39, Employee Benefits and IPSAS 40, Public Sector Combinations;**

...

AG23. A statement of intent or public announcement by a transfer provider such as a government promise to spend money or deliver goods and services in a certain way is not, in and of itself, an enforceable arrangement for the purposes of this [draft] Standard. Such a declaration is general in nature and does not create a binding arrangement between a transfer provider and a transfer recipient. A transfer recipient would need to consider whether such a public announcement gives rise to a non-legally binding (constructive) obligation under IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

Extracts from IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* (as proposed to be amended by ED 71)

107. The disclosure requirements in paragraph 105 encompass contingent assets from both ~~exchange and non-exchange~~ transactions with performance obligations and those without performance obligations. Whether a contingent asset exists in relation to taxation revenues rests on the interpretation of what constitutes a taxable event. The determination of the taxable event for taxation revenue and its possible implications for the disclosure of contingent assets related to taxation revenues are ~~to be dealt with as a part of a separate project on non-exchange~~ addressed in [draft] IPSAS [X] (ED 71), *Revenue without Performance Obligations*.

...

Example 32—Disclosure of a Transfer Subject to Appropriations

- IE83. The facts are the same as in Case A of Example 30. The local government does not recognize an asset for the CU5 million to be transferred in 20X3 as at December 31, 20X2. Rather, the local government considers whether it should disclose a contingent asset, in accordance with paragraph 105 of IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

...

ED 71 Specific Matter for Comment 3 (Paragraphs 57–58)

The IPSASB decided that a transfer recipient recognizes revenue without performance obligations but with present obligations when (or as) the transfer recipient satisfies the present obligation.

Do you agree that sufficient guidance exists in this [draft] Standard to determine when a present obligation is satisfied and when revenue should be recognized? For example, point in time or over time. If not, what further guidance is necessary to enhance clarity of the principle?

In light of our response to SMC 1 we disagree with SMC 3.

ED 71 Specific Matter for Comment 4 (Paragraphs 80–81)

The IPSASB decided that the objective when allocating the transaction price is for a transfer recipient to allocate the transaction price to each present obligation in the arrangement so that it depicts the amount to which the transfer recipient expects to be entitled in satisfying the present obligation. The amount of revenue recognized is a proportionate amount of the resource inflow recognized as an asset, based on the estimated percentage of the total enforceable obligations satisfied.

Do you agree sufficient guidance exists in this [draft] Standard to identify and determine how to allocate the transaction price between different present obligations? If not, what further guidance is necessary to enhance clarity of the principle?

In light of our response to SMC 1 we have not answered this question.

ED 71 Specific Matter for Comment 5 (Paragraphs 84–85)

Do you agree with the IPSASB’s proposals that receivables within the scope of this [draft] Standard should be subsequently measured in accordance with the requirements of IPSAS 41, *Financial Instruments*? If not, how do you propose receivables be accounted for?

We support the intention to establish subsequent measurement requirements for all receivables and aspects of these proposals. However, we think that the proposals need to be refined, both in ED 70 and ED 71. Many of our comments on ED 71 would also apply to ED 70. We have also commented on the proposals for payables and binding arrangement balances in ED 72 (see ED 72 SMC 6).

Scope sections affect the drafting of subsequent measurement requirements

We agree that receivables that are financial instruments should be subsequently measured in accordance with IPSAS 41 *Financial Instruments*. However, we would prefer that the IPSASB set up the scope sections of ED 71 and IPSAS 41 in a manner similar to IFRS 15 and IFRS 9 *Financial Instruments*. This is because IFRS 15 and IFRS 9 distinguish between (i) rights that are financial instruments and to which all of IFRS 9 applies and (ii) rights that only some parts of IFRS 9 are applied to. We think this distinction is especially important for ED 70 and ED 71 because the IPSASB is contemplating a broader group of rights than the IASB, many of which are not financial instruments. Although this SMC is asking about subsequent measurement, we think the scope sections and initial measurement requirements need to be revised before the subsequent measurement requirements are finalised. For example, if the scope sections are revised in accordance with our suggestions, then paragraph 84(a) would not be required.

IFRS 15 and IFRS 9 distinguish between receivables and contract assets as follows.

- Receivables (unconditional rights to consideration) *that are financial instruments* fall within the scope of IFRS 9. This is achieved via IFRS 15 paragraph 108 and IFRS 9 paragraph 2.1(j).
- Contract assets (rights to consideration that are conditioned on something other than the passage of time) are recognised and measured in accordance with IFRS 15 and are subsequently assessed for impairment in accordance with IFRS 9. This is achieved via IFRS 15 paragraphs 107 and 108, and IFRS 9 paragraphs 2.1(j) and 2.2. Collectively these paragraphs scope contract assets out of IFRS 9 but specify that the impairment requirements in IFRS 9 shall be applied to contract assets.

This approach keeps the overall scope of IFRS 9 limited to financial instruments but it also allows certain requirements within IFRS 9 to be applied to rights and obligations that are not financial instruments or that have been excluded from the scope of IFRS 9 (such as contract assets). We think that the overall scope of IPSAS 41 should also be limited to financial instruments, but the IPSASB should then specify which parts of IPSAS 41 apply to receivables that are not financial instruments (such as receivables from binding arrangements that are not contracts and receivables from fines, penalties and taxes) or which have been scoped out of IPSAS 41 (such as binding arrangement assets).

Subsequent measurement of receivables that are financial instruments

If the scope sections of ED 71 and IPSAS 41 are revised in line with our suggestions above, then there would be no need to specify the subsequent measurement of such receivables in ED 71 (ie there would be no need for ED 71 paragraph 84(a)). There could be an explanatory comment in ED 71 noting that any receivables that fall within the scope of IPSAS 41 are subject to the subsequent measurement requirements in IPSAS 41.

Subsequent measurement of receivables that are not financial instruments

With respect to receivables that arise from a binding arrangement, we support the proposals in paragraphs 84(a) and 85. We think the application of the amortised cost requirements in IPSAS 41 to non-contractual receivables needs more explanation, as IPSAS 41 paragraph 40 refers to collecting contractual cash flows. This might be done by explaining that to be measured at amortised cost as per IPSAS 41, the non-contractual receivable must be solely payments of interest and principal and must be managed *similarly* to contractual receivables that are held to collect contractual cash flows.

With respect to receivables from taxes, fees and fines, we partially support the proposals. As per our comments on the 2017 CP, we consider that subsequent measurement of statutory receivables at fair value represents a workable approach. However, we do not agree that an entity with statutory receivables should first have to consider whether it meets the criteria for amortised cost. We would expect these receivables to fail the management model and SPPI test more often than other receivables and wonder whether an entity would be able to make the assessments in some cases. We think these proposals would introduce unnecessary compliance costs.

In addition, for those statutory receivables that meet the criteria for amortised cost, the impairment requirements in IPSAS 41 are likely to be difficult to apply. Determining whether there has been a significant increase in credit risk and expected credit losses can be challenging and involve considerable judgement. It is likely to be even more difficult for statutory receivables which are levied without consideration of credit risk and which are not managed using credit risk in the way that IPSAS 41 envisages. Some public sector entities could have a large number of statutory receivable balances and limited, if any, credit history or forward-looking information about the ability or inclination of the individual or entity to pay.

We acknowledge that the discussion of changes in credit risk in IPSAS 41 (paragraph 81) refers to “reasonable and supportable information that is available without undue cost or effort” but we are concerned that, in the absence of guidance about how to make this call, public sector entities could incur significant compliance costs for little or no benefit in terms of better information for decision making and accountability. If the IPSASB keeps amortised cost as an option for subsequent measurement of statutory receivables we think that more guidance would be needed to help entities understand how to apply the requirements to statutory receivables, particularly around the application of the complex three-stage expected credit loss model. Another option would be to require the use of the ‘simplified approach for receivables’ in IPSAS 41 for statutory receivables.

Subsequent measurement of binding arrangement assets

We support the proposal in ED 71 paragraph 123 that binding arrangement assets be assessed for impairment in accordance with IPSAS 41. However, if the scope sections of ED 71 and IPSAS 41 are revised in the way we suggest, then there is no need to limit IPSAS 41 paragraph 3 to rights that give rise to financial instruments.

Other comments on SMC 5

As a result of looking at the paragraphs relating to this SMC we have a few other comments.

- (a) The statement in ED 71 paragraph 124 (ED 70 paragraph 107) that an entity shall account for a receivable in accordance with IPSAS 41 is too broad, given that some receivables under ED 71 will be non-contractual.
- (b) If both ED 70 and ED 71 amend a paragraph in a standard, the combined amendments to that paragraph should be shown in both EDs, so that readers can see the combined effect of the proposals (for example both ED 70 and ED 71 propose to amend paragraph 3 of IPSAS 41).

ED 71 Specific Matter for Comment 6 (Paragraphs 126–154)

The disclosure requirements proposed by the IPSASB for revenue transactions without performance obligations are intended to provide users with information useful for decision making, and to demonstrate the accountability of the transfer recipient for the resources entrusted to it.

Do you agree the disclosure requirements in this [draft] Standard provide users with sufficient, reliable and relevant information about revenue transactions without performance obligations? In particular, (i) what disclosures are relevant; (ii) what disclosures are not relevant; and (iii) what other disclosures, if any, should be required?

Quantum of disclosures

In our view, there are too many disclosures in ED 71 and we recommend that the IPSASB reconsiders all the disclosure requirements to see if they provide information that is relevant for users of the financial statements. We note that the disclosure requirements in ED 71 relating to binding arrangements with present obligations have been aligned with the disclosure requirements in ED 70, amended as necessary for consistency with the terminology used in ED 71. We question whether this is an appropriate way to determine the disclosures for revenue from transactions with present obligations, bearing in mind that a number of the disclosure requirements in IFRS 15 were developed with complex long-term contracts like construction contracts in mind. Aligning the equivalent disclosures in ED 70 and ED 71 could result in the disclosure requirements in ED 71 for binding arrangements with present obligations being more detailed than is necessary.

Furthermore, we question whether sufficient consideration has been given to the disclosure requirements in ED 71 in light of the scope of the standard and user information needs.

Lack of rationale for the disclosure requirements

We note that the Basis for Conclusions on ED 71 is silent regarding the IPSASB's rationale for the disclosure requirements in ED 71. It is broadly accepted by national and international standard setters that the purpose of issuing an ED is to obtain stakeholder feedback on the proposed standard. Consequently, the Basis for Conclusions which accompanies the ED should be well-articulated and sufficiently comprehensive for stakeholders to understand the rationale for the IPSASB's proposals. This lack of rationale in the Basis for Conclusions (i) is not helpful for stakeholders in deciding whether or not they agree with the IPSASB's proposals, and (ii) puts the onus on stakeholders to undertake a detailed analysis of the disclosures without the benefit of the IPSASB's rationale for requiring the disclosures in the first place. The decision regarding what disclosures to propose in an ED should be taken by the IPSASB after due consideration and robust discussion at IPSASB meetings (of which we have not found evidence when looking at meeting papers). Lack of due consideration and discussion of the proposals in an ED is likely to result in a diverse range of views about the disclosure requirements. This could result in the IPSASB having to spend time considering and discussing those diverse views, and possibly issuing another ED for comment.

Structure of disclosure requirements

We recommend that the disclosures be reorganised to reflect the structure of the recognition and measurement requirements in ED 71. As the disclosures are currently organised, it is difficult to identify which disclosures relate to revenue with present obligations as some of the disclosures are

general (with more detailed disclosures following) and some appear to be duplicated. (For example, paragraphs 131(b) and 143(a) both require an entity to disclose the amount of receivables recognised at the reporting date.) This means that the disclosures for revenue with present obligations occur in a number of paragraphs.

Some entities may derive their revenue from only one type of transaction within the scope of ED 71. These entities want to be able to find the relevant disclosure requirements as easily as possible, rather than having to read through all the disclosures to identify which ones are relevant for them. Structuring the disclosure requirements (with appropriate headings) to align with the structure of the recognition and measurement requirements in the ED would help preparers of financial statements to locate the relevant disclosures more easily.

We also note that the heading above paragraph 140 refers to binding arrangements. Binding arrangements may exist in relation to both revenue with, and revenue without, present obligations. However, the disclosures required by paragraph 140 are relevant only for transactions with present obligations.

Disclosures carried over from IPSAS 23

The disclosure requirements in paragraphs 131–136 and 138–139 are carried over from paragraphs 106–108 and 111–115 respectively of IPSAS 23 and amended as appropriate for the terminology used in ED 71. We think the IPSASB should take this opportunity to revisit all the disclosures carried over from IPSAS 23 and consider whether they are still relevant.

Descriptors for revenue disclosures

We acknowledge that ED 71 establishes the principles for an entity to apply to report useful information about revenue derived from a variety of transactions. These transactions are labelled using the terms ‘revenue from transfers with present obligations’, ‘revenue from transfers without present obligations’ and ‘taxes’. Our concern is that these terms will then be used by preparers of financial statements as labels in the financial statements to disaggregate and present revenue from different types of transactions. For example, there is currently considerable debate in practice about whether a transaction is an exchange transaction or a non-exchange transaction, and this flows on to the presentation and disclosure of revenue in the statement of financial performance.

We suggest that the IPSASB revisits the terms used to categorise the revenue streams within the scope of ED 71 and uses terminology that would be more easily understood by both preparers and users of financial statements. Alternatively, the ED could include a paragraph similar to paragraph 22 of IPSAS 1 *Presentation of Financial Statements* (regarding the use of alternative titles for the financial statements) so that entities have the option of using alternative terms that users would understand for revenue from different types of transactions.

ED 71 Specific Matter for Comment 7 (Paragraphs N/A)

Although much of the material in this [draft] Standard has been taken from IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, the IPSASB decided that the ED should establish broad principles for the recognition of revenue from transactions without performance obligations, and provide guidance on the application of those principles to the major sources of revenue for governments and other public sector entities. The way in which these broad principles and guidance have been set out in the ED are consistent with that of [draft] IPSAS [X] (ED 72), *Transfer Expenses*.

Do you agree with the approach taken in the ED and that the structure and broad principles and guidance are logically set out? If not, what improvements can be made?

Compulsory contributions and levies

IPSAS 23 refers to taxes as the major source of revenue for governments. It does not refer to compulsory contributions, apart from in the Basis for Conclusions (which explains that some compulsory contributions to social security schemes might fall within the scope of IPSAS 23).

In contrast, ED 71 refers to taxes, including compulsory contributions and levies, as the major source of revenue for governments. ED 71 defines 'taxes' and 'other compulsory contributions and levies' and requires separate disclosure of revenue from (i) taxes; (ii) other compulsory contributions and levies; and (iii) transfers.

We acknowledge that the IPSASB included guidance on compulsory contributions and levies in response to feedback from some constituents. However, it is not clear that the guidance in paragraphs 27–31 is sufficient to lead to consistent classification of transactions as taxes or other compulsory contributions and levies and there could be unhelpful debates about classification.

We note that ED 71 paragraph 27 says that compulsory contributions and levies are a subset of taxes and the proposed recognition and measurement requirements are the same for both taxes and compulsory contributions and levies. Given that the IPSASB is effectively treating compulsory contributions and levies as taxes, we think ED 71 would be clearer if compulsory contributions and levies (i) were not a defined term and (ii) were explicitly included in the definition of taxes. This would lead to the proposed disclosures for taxes and compulsory contributions and levies in paragraph 131(a)(i) and (ii) being combined.

The first part of our response to this SMC has suggested some redrafting of ED 71, based on the IPSASB's view that compulsory contributions and levies are a subset of taxes. However, we do not agree that all compulsory contributions and levies can be classified as a subset of taxes. They vary in nature and some, such as development contributions which are levied by a council on a developer, may be refundable if a council does not complete land development works within a certain period. In contrast to IPSAS 23, ED 71 does not appear to allow for the recognition of liabilities for compulsory contributions and levies after the taxable event has occurred (unless they are received in advance).

IPSAS 23, paragraph 64, (shown below) acknowledges that a government might recognise a liability for conditions relating to specific purpose tax levies.

Extract from IPSAS 23

64. As noted in paragraph 52, some taxes are levied for specific purposes. If the government is required to recognize a liability in respect of any conditions relating to assets recognized as a consequence of specific purpose tax levies, it does not recognize revenue until the condition is satisfied and the liability is reduced. However, in most cases, taxes levied for specific purposes are not expected to give rise to a liability, because the specific purposes amount to restrictions not conditions.

However, ED 71, paragraph 93, states that taxes do not give rise to performance obligations and paragraph 29 states that taxes do not create binding arrangements (which means that they cannot give rise to present obligations in accordance with ED 71). This appears to preclude the recognition of liabilities for obligations associated with compulsory contributions and levies. Although compulsory contributions and levies are imposed through the use of a government's powers, in our view they can be accompanied by obligations that should be recognised as liabilities and that ED 71 should allow for this.

ED 71 Other comments

The use of the term 'transfer recipient'

ED 71 imposes requirements on the 'transfer recipient'. We acknowledge that the definition of a transfer recipient has been worded generally and covers an entity receiving taxes. However, we think it is confusing for readers (especially in the disclosure section) if the term 'transfers' excludes taxes, but the term 'transfer recipients' includes recipients of taxes.

Revenue with high collection uncertainty

Paragraph 101 (shown below) establishes requirements for the measurement of tax revenue with high collection uncertainty. The meaning of the words "in accordance with paragraphs 69–70" is unclear, given their location at the end of the sentence. We think it would be better to establish separate requirements in paragraph 101.

101. The measurement of assets arising from taxation transactions is limited to the extent that it is highly probable that a significant reversal of the amount of cumulative revenue recognized will not occur in accordance with paragraphs 69–70.

APPENDIX 3 Response to SMCs on ED 72 *Transfer Expenses*

ED 72 Specific Matter for Comment 1

The scope of this [draft] Standard is limited to transfer expenses, as defined in paragraph 8. The rationale for this decision is set out in paragraphs BC4–BC15.

Do you agree that the scope of this [draft] Standard is clear? If not, what changes to the scope or definition of transfer expense would you make?

The interaction between this ED and IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* is not clear. Our comments on SMC 4 and SMC 6 expand on this point.

We have previously expressed concern about dealing with transfer expenses as a separate project. This reflects our preference for consistent requirements for the recognition of liabilities and expenses in relation to non-exchange expense transactions with similar characteristics. Consistent requirements help avoid debates about whether a transaction falls within the scope of one standard or another. Given the recent wave of government subsidies around the world, we considered whether entities would be able to decide whether to apply IPSAS 42 *Social Benefits* or ED 72. Differing views on whether the predominant intent of a subsidy is to support the income of households or the employer could lead to scope debates.

ED 72 Specific Matter for Comment 2

Do you agree with the proposals in this [draft] Standard to distinguish between transfer expenses with performance obligations and transfer expenses without performance obligations, mirroring the distinction for revenue transactions proposed in ED 70, *Revenue with Performance Obligations*, and ED 71, *Revenue without Performance Obligations*?

If not, what distinction, if any, would you make?

We agree with the proposal to distinguish between transfer expenses with performance obligations and transfer expenses without performance obligations.

ED 72 Specific Matter for Comment 3

Do you agree with the proposal in this [draft] Standard that, unless a transfer provider monitors the satisfaction of the transfer recipient's performance obligations throughout the duration of the binding arrangement, the transaction should be accounted for as a transfer expense without performance obligations?

Paragraph 13 of ED 72 sets out the criteria that a transfer provider must meet before it can apply the Public Sector Performance Obligation Approach (PSPOA). Paragraph 13(d) requires that "The transfer provider can identify the transfer recipient's performance obligations *and monitors the satisfaction* of those performance obligations throughout the duration of the binding arrangement."

We agree that an entity must have sufficient and reliable information to assess the extent to which performance obligations have been satisfied in order to be permitted to apply the PSPOA but we think that, as worded, paragraph 13(d) is too restrictive. Monitoring, in our view, implies *continuous assessment* of the recipient's performance obligations, but there could be a number of ways, including monitoring, in which an entity could satisfy itself (and others) about the extent to which a

transfer recipient has satisfied performance obligations. Alternatives to monitoring could include periodic assessments such as milestone certifications, external assurance and periodic monitoring.

We therefore suggest that paragraph 13(d) be worded more generally to reflect the principle that the transfer provider needs to have the ability to assess the satisfaction of the transfer recipient's performance obligations. The application guidance in paragraphs AG26 and AG27 would then need to be rewritten to reflect this principle (see our comments on SMC 5).

ED 72 Specific Matter for Comment 4

This [draft] Standard proposes the following recognition and measurement requirements for transfer expenses with performance obligations:

- (a) A transfer provider should initially recognize an asset for the right to have a transfer recipient transfer goods and services to third-party beneficiaries; and
- (b) A transfer provider should subsequently recognize and measure the expense as the transfer recipient transfers goods and services to third-party beneficiaries, using the public sector performance obligation approach.

The rationale for this decision is set out in paragraphs BC16–BC34.

Do you agree with the recognition and measurement requirements for transfer expenses with performance obligations? If not, how would you recognize and measure transfer expenses with performance obligations?

We broadly agree with the proposed measurement requirements for transfer expenses with performance obligations, as outlined in SMC 4. However, we think that the proposals require more work. Our comments follow.

Interaction with IPSAS 19

The interaction between ED 72 and IPSAS 19 is not clear. We have identified some circumstances in which an entity might think that IPSAS 19 would be relevant and outlined our understanding of the IPSASB's intentions about when an entity applying ED 72 should or should not also consider the requirements in IPSAS 19. We have raised these issues partly to make sure that we have understood the IPSASB's intentions. More importantly however, preparers and auditors need to understand this interaction. In addition, we consider that the requirements for liabilities of uncertain timing and amount and onerous contracts need to be consistent with the requirements in IPSAS 19, as these requirements are applied to a range of other transactions and events.

IPSAS 19 defines a provision as a liability of uncertain timing or amount and explains the distinction between provisions and other liabilities. It also defines onerous contracts and requires that an entity recognise a provision for onerous contracts. Relevant extracts from IPSAS 19 are shown below.

Extracts from IPSAS 19

An onerous contract is a contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.

A provision is a liability of uncertain timing or amount.

Provisions and Other Liabilities

19. Provisions can be distinguished from other liabilities such as payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:

- (a) Payables are liabilities to pay for goods or services that have been received or supplied, and have been invoiced or formally agreed with the supplier (and include payments in respect of social benefits where formal agreements for specified amounts exist); and
- (b) Accruals are liabilities to pay for goods or services that have been received or supplied, but have not been paid, invoiced, or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Accruals are often reported as part of accounts payable, whereas provisions are reported separately.

...

Onerous Contracts

76. **If an entity has a contract that is onerous, the present obligation (net of recoveries) under the contract shall be recognized and measured as a provision.**

Extracts from ED 72

Scope

...

5. **This [draft] Standard does not apply to:**

...

- (b) **Provisions as defined in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*;**
- (c) **Collective services and individual services as defined in IPSAS 19;**

...

We have posed the following questions about transfer expenses with performance obligations and looked to ED 72 for guidance.

- (i) If a transfer provider has a binding arrangement with liabilities that are of uncertain timing or amount, what would it do?
- (ii) If a transfer provider has a binding arrangement with a liability that extends over more than one year, would it need to discount the liability?
- (iii) If a transfer provider has a binding arrangement that become onerous, what would it do?

(i) Liabilities of uncertain timing or amount

ED 72 sets out the criteria that must be met before an entity can apply the PSPOA to transfer expenses. Paragraph 13 requires that the transfer provider must be able to identify each party's rights and the payment terms. We would expect that these criteria will lead to liabilities of certain timing and amount.

We have thought about what a transfer provider would do if a transfer were contingent upon the recipient doing something else, such as obtaining funding from another party. Paragraphs 51 to 59 deal with variable consideration but the examples in paragraph 52 do not indicate whether they are

intended to apply to transactions where the whole, or a substantial portion, of the consideration is contingent upon another event. An entity applying ED 72 might decide that such transactions did not satisfy the requirements in paragraph 13 of ED 72. However, it would be helpful if this were clear.

An entity might also wonder if it had a contingent liability that should be disclosed in accordance with IPSAS 19. It is not clear (after looking at ED 72 paragraph 5(b) which refers to 'provisions') whether the IPSASB intended an entity to apply IPSAS 19 in such situations or not.

We note that the requirement in paragraph 51 of ED 72 (to estimate variable consideration) is similar to the best estimate requirement in IPSAS 19.

(ii) Liabilities that extend over a year

IPSAS 19 (paragraph 44) requires that, when the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditure expected to be required to settle the obligation.

ED 72 (paragraphs 60 to 68) would require discounting if a transaction involves a significant financing component. Although these requirements differ from those in IPSAS 19 we acknowledge that they are similar to the requirements in ED 70 and agree that they are appropriate for transfer expenses *with performance obligations*.

(iii) Onerous arrangements

ED 72 does not discuss how to assess whether a transfer expense with performance obligations has become onerous or how to account for such transactions. ED 72 paragraph 5(b) excludes provisions, as defined in IPSAS 19, from its scope. We read that as meaning that a transfer provider should not apply IPSAS 19 in assessing whether an arrangement for the provision of goods and services to third party beneficiaries has become onerous in deciding how to account for such an arrangement. If this is the IPSASB's intention it would be helpful to explain this in the ED, and for the ED to explain how to deal with arrangements that become onerous.

Proposed subsequent measurement requirements are not complete

In our view the proposed requirements for subsequent measurement of binding arrangement liabilities associated with transfer expenses with present obligations (as set out in paragraph 124, shown below) are not complete.

ED 72 paragraph 124

124. A payable is a transfer provider's obligation to pay consideration that is unconditional. An obligation to pay consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, a transfer provider would recognize a payable if it has a present obligation to make payment even though that amount may be subject to refund in the future. A transfer provider shall account for a payable in accordance with IPSAS 41.

We have identified the aspects which we think require more work in the following table.

Types of liabilities	ED 72 subsequent measurement proposals and comments
Contractual conditional obligation	The ED does not appear to discuss the subsequent measurement of such liabilities.
Non-contractual conditional obligation	The ED does not appear to discuss the subsequent measurement of such liabilities.
Contractual unconditional payable (financial instrument)	ED 72 paragraph 124 says to account for payables in accordance with IPSAS 41. We agree with this requirement.
Non-contractual unconditional payable	ED 72 paragraph 124 says to account for payables in accordance with IPSAS 41. However, not all payables will be financial liabilities that fall within the scope of IPSAS 41. We think that the subsequent measurement requirements for PSPOA payables that are not financial liabilities need to be identified in this ED.

Location of measurement requirements

ED 72 proposes to create three sets of measurement requirements. We mention these three sets of requirements because, in our view, some of them should be relocated.

- (a) Transfer expenses with performance obligations (initial measurement in paragraph 47 and subsequent measurement in paragraphs 121–125).
- (b) Transfer expenses without performance obligations (initial measurement in paragraphs 102–104 and subsequent measurement in paragraphs 116–19).
- (c) Non-contractual payables that are not transfer expenses (paragraph 120).

In our view the requirements for subsequent measurement of balances associated with transfer expenses with performance obligations should be located near the section dealing with the initial measurement of such balances (paragraphs 47 to 89), not in the section on presentation. We acknowledge that the location of these subsequent measurement requirements reflects the location of similar requirements in IFRS 15 *Revenue from Contracts with Customers* and ED 70. However, this location does not work in ED 72 because the initial and subsequent measurement of these balances is interrupted by the section dealing with transfer expenses without performance obligations. The presentation section will still need to discuss the separate presentation of payables from other binding arrangement liabilities.

ED 72 Specific Matter for Comment 5

If you consider that there will be practical difficulties with applying the recognition and measurement requirements for transfer expenses with performance obligations, please provide details of any anticipated difficulties, and any suggestions you have for addressing these difficulties.

We have heard some concerns that transfer providers and auditors might have differing views about whether a provider has sufficient information (about the satisfaction of obligations by the recipient) to apply the PSPOA. Entities applying ED 72 will first look at paragraph 13 which sets out the criteria that must be met in order to apply the PSPOA. We expect that entities will have no difficulty in determining whether they meet the criteria in paragraph 13(a)–(c). However, we think that entities could benefit from some additional guidance about what to consider in deciding that they meet the criterion in paragraph 13(d) (which refers to monitoring the satisfaction of performance obligations).

Our response to SMC 3 suggests that paragraph 13(d) be worded more generally and that application guidance be used to explain *how* an entity could satisfy itself (and others) about the extent to which a recipient has satisfied performance obligations and how much more effort is required for complete satisfaction. This would require rewriting paragraphs AG26 and AG27. We also have some comments on paragraphs AG26 and AG27 as drafted.

The ED states that paragraphs AG26 and AG27 (shown below) provide additional guidance. However, an entity reading these AG paragraphs will find an explanation of why monitoring is a requirement, rather than guidance on what to consider when making this assessment.

Extract from ED 72**Identifying the Binding Arrangement (Step 1) (see paragraphs 13–23)**

AG26. The criteria a transfer provider considers in determining when to account for a transfer expense with performance obligations are similar to those an entity would consider in determining when to account for revenue in accordance with [draft] IPSAS [X] (ED 70). However, in determining when to account for a transfer expense with performance obligations, a transfer provider does not need to consider whether the binding arrangement has economic substance. A transfer expense is the transfer of a good or service by the transfer provider without the transfer provider directly receiving a good or service in return, and consequently all transfer expenses have economic substance.

AG27. In accordance with paragraph 13(d), a transfer provider may account for a transfer expense as a transfer expense with performance obligations only if it monitors the transfer recipient's satisfaction of its performance obligations. This is because, without such monitoring, the transfer provider would not have reliable information about when a transfer expense arises. Without such information, the recognition of an expense could be inappropriately delayed. Consequently, where the transfer provider does not monitor the transfer recipient's satisfaction of its performance obligations, a transfer provider shall account for the transfer expense as a transfer expense without performance obligations.

ED 72 Specific Matter for Comment 6

This [draft] Standard proposes the following recognition and measurement requirements for transfer expenses without performance obligations:

- (a) A transfer provider should recognize transfer expenses without performance obligations at the earlier of the point at which the transfer provider has a present obligation to provide resources, or has lost control of those resources (this proposal is based on the IPSASB's view that any future benefits expected by the transfer provider as a result of the transaction do not meet the definition of an asset); and
- (b) A transfer provider should measure transfer expenses without performance obligations at the carrying amount of the resources given up?

Do you agree with the recognition and measurement requirements for transfer expenses without performance obligations?

If not, how would you recognize and measure transfer expenses without performance obligations?

We broadly agree with the proposed measurement requirements for transfer expenses without performance obligations, as outlined in SMC 6. However, we think that the proposals require more work. Our comments follow.

Paragraphs 91–94

There are some drafting issues in paragraphs 91–94 of ED 72 which have made them difficult to follow. ED 72 needs to focus on the present obligations of the *transfer provider*. As drafted, paragraphs 91–94 appear to be focusing on the present obligations of the *recipient*.

We agree with the requirement (in paragraph 91) for a transfer provider to recognise a transfer expense when the transfer provider has a present obligation. We also agree that a present obligation should be enforceable.

However, paragraph 92 then goes on to link the concept of a present obligation of the transfer provider with present obligations *on the transfer recipient*. Paragraph 92 says that, in order for a transfer provider to have a present obligation there must be a binding arrangement. A binding arrangement (as defined in ED 70) creates *both enforceable rights and obligations on both parties to the arrangement*. We think that a transfer provider could have a present obligation to transfer resources to a transfer recipient (that could be enforced by the recipient) without there being both enforceable rights and obligations on both parties. We think that paragraph 92 is confusing the concept of a present obligation of the transfer provider with a present obligation of the recipient. We think that you can have one without the other.

With regard to paragraph 93, we do not think it is correct to say that “transfers to be made outside of a binding arrangement are not enforceable.” We do not think that deeds would meet the definition of a binding arrangement in ED 70, but deeds are enforceable. In New Zealand a range of legal documents (contracts, agreements and deeds), not all of which establish obligations on the other party, might be used as the basis for an agreement to make a grant. A promise (made verbally or in writing) is legally enforceable if the other party is giving something in return, or the promise is recorded in a deed. Unlike a contract, a promise in a deed is enforceable whether or not there is any payment or consideration given for it.

We have also noted a possible drafting error in paragraph 94. We think that the IPSASB intended to say that a transfer provider does not have a present obligation in these circumstances. As written, the sentence says that the transfer expense does not exist.

Multi-year grants

We have found it difficult to form a view about the treatment of multi-year grants under ED 72 because paragraphs 91–94 are not clear. We do not think there is enough guidance to lead to consistent treatment of multi-year grants. Example 34 *Agreement for a Series of Transfers* (paragraphs IE180–IE84) indicates that a transfer provider would recognise an upfront liability for all payments within a multi-year agreement if there is an unconditional obligation. However, we think that this needs to be clearer within the ED itself.

Interaction with IPSAS 19

As per our response to SMC 4, we are not clear about the interaction between ED 72 and IPSAS 19 and, to the extent that ED 72 establishes requirements for liabilities that would otherwise be recognised and measured in accordance with IPSAS 19, we think that any differences in requirements should be immediately apparent and justified by differing circumstances.

We have posed the same questions (as per SMC 4) to transfer expenses *without* performance obligations and looked to ED 72 for guidance.

- (i) If a transfer provider has a binding arrangement with liabilities that are of uncertain timing or amount, what would it do?
- (ii) If a transfer provider has a binding arrangement with a liability that extends over more than one year, would it need to discount the liability?
- (iii) If a transfer provider has a binding arrangement that becomes onerous, what would it do?

In addition, we have considered how a transfer provider would decide whether it needs to recognise a provision for a constructive obligation.

(i) Liabilities of uncertain timing or amount

Paragraphs 102 to 115 of ED 72 deal with initial measurement of liabilities for transfer expenses without performance obligations. We agree with the requirement in paragraph 103 to measure a liability at the best estimate of the costs that the transfer provider will incur in settling the liability and note that this is consistent with the requirement in IPSAS 19 to measure a provision at the best estimate of the expenditure required to settle the liability.

Paragraph 108 addresses variable consideration, but only in very specific circumstances (that is, only in the context of a transfer provider funding a recipient for the recipient's expected costs). We think that transfer expenses could be contingent on other factors, such as the transfer recipient raising funds from elsewhere. We cannot see where ED 72 deals with these other types of contingencies or how a transfer provider would know whether it has a contingent liability that should be disclosed in accordance with IPSAS 19.

(ii) Liabilities that extend over a year

IPSAS 19 requires that, when the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.

ED 72 (paragraphs 109 to 113) would require discounting if the timing of payments agreed to by the parties to the binding arrangement (either explicitly or implicitly) provides the transfer recipient with a significant benefit of financing the activities the transfer recipient has agreed to perform. We agree with the proposal to require an entity to take account of the time value of money, but are not sure how an entity making a transfer would determine that a transaction provides a significant benefit of financing (as per paragraphs 109 and 110) or the rate that would be used in a separate financing transaction between the parties (as per paragraph 111). We are also not sure that a transfer provider would be likely to provide any collateral. We wonder if it would be better to have a general requirement, similar to that in IPSAS 19, to discount a liability if the effect of the time value of money is material. We are aware that our comments here differ from what we said in SMC 4, but these are different types of transactions.

(iii) Onerous arrangements

ED 72 does not discuss whether transfer expenses without performance obligations can become onerous, and if so, how to account for them. ED 72 excludes provisions, as defined in IPSAS 19, from its scope. We read that as meaning that the onerous contract requirements in IPSAS 19 do not apply to transfer expenses without performance obligations. We think the ED should be more explicit about whether an arrangement for transfer expenses without performance obligations can become onerous, and if so, how to account for them (bearing in mind that such arrangements may be: (i) binding arrangements with performance obligations that do not meet the criteria in paragraph 13; (ii) binding arrangements without performance obligations; or (iii) arrangements that are not binding).

(iv) Constructive obligations

A transfer provider might not have an enforceable obligation to make a transfer but nevertheless it might be concerned about whether it has to recognise a provision for a constructive obligation. ED 72 excludes provisions, as defined in IPSAS 19, from its scope. We read that as meaning that a transfer provider should not apply IPSAS 19 in assessing whether it needs to recognise a provision for a constructive obligation. However, paragraph AG23 (shown below) says that a transfer provider should apply IPSAS 19 in deciding whether it has a constructive obligation.

Extract from ED 72

AG23. A statement of intent or public announcement by a transfer provider such as a government promise to spend money or deliver goods and services in a certain way is not, in and of itself, an enforceable arrangement for the purposes of this [draft] Standard. Such a declaration is general in nature and does not create a binding arrangement between a transfer provider and a transfer recipient under which both parties have rights and obligations. A transfer provider considers whether such a public announcement gives rise to a constructive obligation in accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

Subsequent measurement of non-contractual payables that are not transfer expenses

ED 72 paragraph 120 also specifies the subsequent measurement of other non-contractual payables arising out of the operation of legislation or regulation. At the moment these requirements are located at the end of the section on measurement of transfer expenses without performance obligations. We do not object to requirements for such payables being included in this ED but, as they are not transfer expenses, we consider that they should be located in a separate section.

ED 72 Specific Matter for Comment 7

As explained in SMC 6, this [draft] Standard proposes that a transfer provider should recognize transfer expenses without performance obligations at the earlier of the point at which the transfer provider has a present obligation to provide resources, or has lost control of those resources. ED 71, *Revenue without Performance Obligations*, proposes that where a transfer recipient has present obligations that are not performance obligations, it should recognize revenue as it satisfies those present obligations. Consequently, a transfer provider may recognize an expense earlier than a transfer recipient recognizes revenue.

Do you agree that this lack of symmetry is appropriate? If not, why not?

We agree with the proposal that a transfer provider should recognise transfer expenses without performance obligations at the earlier of the point at which the transfer provider has a present obligation to provide resources, or has lost control of those resources.

As explained in our comment letter on the 2017 CP, the key issues relating to the recognition of non-exchange expenses are primarily concerned with determining when the resource provider has incurred a liability to transfer resources to another party. This involves identifying when the resource provider has a present obligation arising from a past event. In certain circumstances, the timing of expense recognition would be impacted by whether a payment is made before or after an obligating event has occurred. Expenses may be recognised earlier when prepaid (when the resource provider no longer has control over the resources transferred).

We acknowledge that asymmetry between the recognition of revenue by a resource recipient and recognition of the corresponding transfer expense creates issues for consolidation when the resource recipient and the transfer provider are part of the same economic entity. These sorts of consolidation issues exist currently and are relevant only to the extent that they affect compliance costs – they should not, however, drive accounting requirements.

ED 72 Specific Matter for Comment 8

This [draft] Standard proposes that, when a binding arrangement is subject to appropriations, the transfer provider needs to consider whether it has a present obligation to transfer resources, and should therefore recognize a liability, prior to the appropriation being authorized. Do you agree with this proposal?

If not, why not? What alternative treatment would you propose?

We have not answered this question.

ED 72 Specific Matter for Comment 9

This [draft] Standard proposes disclosure requirements that mirror the requirements in ED 70, *Revenue with Performance Obligations*, and ED 71, *Revenue without Performance Obligations*, to the extent that these are appropriate.

Do you agree the disclosure requirements in this [draft] Standard are appropriate to provide users with sufficient, reliable and relevant information about transfer expenses? In particular,

- (a) Do you think there are any additional disclosure requirements that should be included?
- (b) Are any of the proposed disclosure requirements unnecessary?

Quantum of disclosures

Consistent with our views on the disclosure requirements in ED 71, we think there are too many disclosure requirements in ED 72 and recommend that the IPSASB reconsider the disclosure requirements to see if all of them provide information that is relevant for users of the financial statements.

The disclosure requirements in ED 72 mirror the equivalent disclosure requirements in ED 70 and ED 71. This results in a significant number of disclosures relating to transfer expenses, in particular for transfer expenses with performance obligations. We are not aware of any other category of expenses that is required to be disclosed in such detail and do not think that this level of detail is appropriate.

We have thought about what users of general purpose financial statements might want to know about transfer expenses with performance obligations. We consider that they are most likely to be interested in the overall balance of accruals, not the detail. We note that the IPSASB also seems to have been of this view at an earlier stage of the process (see ED 72 paragraph BC69) and subsequently decided to require more disclosures. We agree with the IPSASB's rationale in paragraph BC69 for its earlier view not to include disclosure requirements for the disaggregation of expenses and the detailed information on binding arrangement balances.

Descriptors for transfer expense disclosures

Consistent with our views expressed in response to SMC 6 of ED 71, we suggest that the IPSASB revisits the terms used to categorise transfer expenses within the scope of ED 72 and uses terminology that would be more easily understood by users of financial statements.