

AC-4-5

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Dear Ross

**EXPOSURE DRAFTS – IPSASB ED’S 70-72**

Thank you for the opportunity to respond to the IPSASB Exposure Drafts (ED) 70-72. The New Zealand Treasury is responsible for the New Zealand Government’s accounting policies that comply with NZ GAAP for the public sector based on IPSAS.

The attachment to this letter sets out NZ Treasury’s response to the specific matters for comment. Broadly NZ Treasury agrees with ED 70 *Revenue with Performance Obligations*, but has significant concerns with both ED 71 *Revenue without Performance Obligations* and with ED 72 *Transfer Expenses*.

If you have any queries regarding Treasury’s comments, please contact Ken Warren or Angela Ryan by email to [ken.warren@treasury.govt.nz](mailto:ken.warren@treasury.govt.nz) or [angela.ryan@treasury.govt.nz](mailto:angela.ryan@treasury.govt.nz)

Yours sincerely

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**EXPOSURE DRAFTS 70-72: REVENUE WITH AND WITHOUT PERFORMANCE OBLIGATIONS AND TRANSFER EXPENSES. SPECIFIC MATTERS FOR COMMENT**

**ED 70 Revenue with Performance Obligations**

**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?

NZ Treasury agrees with the scope, which is necessary for harmonisation with IFRS 15. However, just because there is a standard for revenue with performance obligations and another for revenue without performance obligations, does not mean there is clarity in the scopes. The critical criteria for making the distinction to determine which standard is applicable is a judgement as to whether the binding arrangements establish enforceable rights of the revenue recipient to an asset and a performance obligation to the funder/beneficiary. There is still room for inconsistent judgements on those issues as a result of this guidance in these proposed standards.

**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?

NZ Treasury agrees. A definition would not impact on the guidance.

**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?

NZ Treasury agrees with the application guidance set out in paragraphs AG69 and AG70.

**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?

Treasury agrees that the disclosure requirements should be aligned with those in IFRS 15. We note that disclosures are only required where material (ED 70(112)).

**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?

Treasury agrees.

## ED 71 *Revenue without Performance Obligations*

### 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?

The NZ Treasury does not agree that a transfer recipient has a liability as defined in the conceptual framework where it does not have outstanding performance obligations as defined in ED 70, but rather is only required to perform a specified activity or incur eligible expenditure.

The current proposals are too broad.

Most public sector entities' powers and functions are specified in law. Funding arrangements are not likely to expand these powers and functions. These overall schemes of arrangements are likely to be binding on the entity. Consequently, all public sector entity funding could, under this proposed guidance, establish performance obligations, because that funding can only be used for specified activity and eligible expenditure.

Given that funding that can only be used for specified activity and eligible expenditure may still be used at the reporting entity's discretion or maintained in reserve, the plain meaning of the liability element in the conceptual framework is not met. The proposed guidance therefore corrupts the meaning of liability in the Conceptual Framework to include unspent funding or revenue.

Further the proposals would set off a number of unhelpful debates as preparers and auditors struggle to comply. These would include debates over the specificity of the activity and the strength of the link between funding and enforceability of suggested obligations. Users of IPSAS compliant financial statements are not well served when fine judgements of such matters of lesser interest are likely to have a significant impact on the financial results that are reported to them.

The NZ Treasury accepts that unspent funding or revenue may be a useful thing to report in the financial statements, although the case should be specifically made for that.

If that is the case, the IPSASB may wish to either pursue disclosure options, or to make use of the "other obligations" designation as set out in paragraph 5.4 of the Conceptual Framework. The drafters of the Conceptual Framework foresaw that in some circumstances, to ensure that the financial statements provide information that is useful

for a meaningful assessment of the financial performance and financial position of an entity, recognition of economic phenomena that are not captured by the elements may be necessary. They therefore specifically provided that the IPSASB may require or allow the recognition of resources or obligations that do not satisfy the definition of an element (as “other obligations”) when necessary to better achieve the objectives of financial reporting.

**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?

The Treasury agrees.

**Specific Matter for Comment 3: (Paragraph 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. We note also that this proposed standard would result in an additional burden on public sector entities to gather information on their fulfilment of present obligations so as to recognise revenue. That may not always be clear, especially when funding is provided to carry out ongoing activities, or projects that have multiple stages. The application guidance and illustrative examples in ED 71 appear limited on this issue

**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.

**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?

There is an unidentified conflict between the requirements of

- IPSAS 41 which requires receivables to initially be measured at fair value, and then subsequently either at amortised cost or fair value
- ED 71 which requires receivables to initially be recognised at transaction price (excluding credit losses) and then subsequently as per IPSAS 41

Take as an example a fine that is imposed by the judiciary on a beneficiary dependent on the public sector for income support. The judicial administrator then immediately agrees a payment arrangement to collect the full amount over an extended period in time, creating a receivable for which the fair value is well below the transaction price.

In other cases, tax assessments may be levied at punitive rates, to incentivise progress towards agreements on final arrangements.

The impairment requirements of IPSAS 41 are not equipped to deal with such unique public sector transactions, and clarification in this area is needed.

The Treasury would propose that the ED 71 explicitly provide for initial recognition at transaction price (for accountability purposes) and, where specified as necessary, and with guidance as appropriate, immediate impairment to fair value, before subsequently applying IPSAS 41.

We also propose that the IPSASB provides guidance on the use of the simplified expected credit loss model in IPSAS 41 for statutory receivables classified as amortised cost. Given the practical challenges in applying the more complex three-stage expected loss model in IPSAS 41, and given credit assessment is generally not a

factor in whether a statutory levy or tax is applied, we would support the simplified expected credit loss model being the default model to apply.

**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?

The Treasury notes that the disclosures are only required where material (ED 71(130)). Nevertheless, we consider the disclosure requirements may still be detailed and onerous, particularly at the level of individual agencies.

It appears that the disclosure requirements have been adapted from the requirements in ED 70, rather than specifically considering what information and why, users would value regarding the entities use (and non-use) of funding provided to it.

The Treasury recommends that IPSASB revisits these requirements on a first principles basis, applying the principles in Chapter 7 of the Conceptual Framework.

**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?

Treasury generally agrees with this guidance. IPSASB should be aware this guidance will be used for carbon taxes, and the accounting for advance payments to purchase emission units and the accounting when an emitter has an obligation to surrender those emission trading units when specified carbon emissions takes place. While the NZ Treasury is comfortable with the accounting that ensues, we are less comfortable that these implications have been given due process consideration.

## **Other Comments: Appropriations (paragraphs 36 and 37)**

ED 71 notes that even if an arrangement is specified as being subject to appropriations, the arrangement may still be considered binding if the transfer recipient can establish an enforceable right before the appropriation is authorised.

It is an interesting stance from the standard setter to assert that appropriations may have legal form without economic substance. But leaving that aside, the more common scenario is that in some jurisdictions an appropriation may be the actual mechanism whereby a binding arrangement may be considered to be put in place whereby the public sector entity gains control of an asset.

However the ED is not helpful in determining if such a judgement is appropriate. The discussion in ED 71 AG 30-32 suggests that there may be a distinction between:

- an (appropriation) authority being enabled to be provided, e.g. through legislation
- an (appropriation) authority being exercised, so that an outflow must occur
- an (appropriation) authority being settled, with payment being made

The discussion however does not provide guidance as to when the recipient should recognise revenue, except to state that substance must be determined. The proposed standard lacks guidance on the criteria for determining the substance of the transaction.

An appropriation is defined in IPSAS 24, Presentation of Budget Information in Financial Statements, as an authorization granted by a legislative body to allocate funds for purposes specified by the legislature or similar authority. That seems to refer to just the first stage above – if it is intended to widen the definition to include the exercise and payment by the Executive, then the case for doing so should be made explicit.

Having said that, separating the appropriation into stages may be helpful. In New Zealand, with accrual based appropriations, the first stage is the passing of the Appropriation Act or permanent legislative authority, the second stage is when the costs are incurred by the entity, and the third stage (which may be in advance of the third stage) is when payment is made to the entity. In other jurisdictions with commitment and cash-based appropriations, the second stage would be when the commitment is made, and the third stage is where the payment is made. Pure cash based appropriations, might effectively combine stages 2 and 3.

What the ED fails to address are other possible jurisdictional arrangements, relevant to a determination as to whether an appropriation establishes a binding arrangement with performance obligations, other (“present”) obligations or no obligations. The appropriation may:

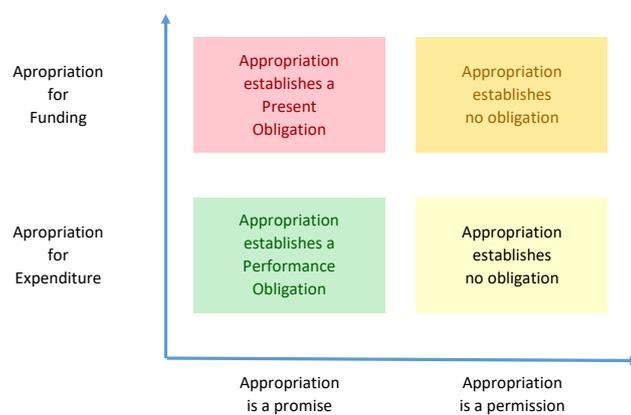
- specify the allocation of funds to the reporting entity, or it may specify the expenditure incurred by the reporting entity for purposes specified
- represent the permission of the legislative body or the promise of a legislative body

In some jurisdictions where there is a centralised system for the management and payment of appropriations, and no separate transactions to and from the reporting entity, the first distinction may not be important. However, in decentralised,

performance-based appropriation systems, where there is a separation between the funding of reporting entities and their expenditure, it will be important to be clear what the appropriation refers to.

In some jurisdictions, typically where the legislative body exerts greater budgetary power over the executive, the substance of the appropriation is a requirement to spend the money allocated to the purpose. For other jurisdictions, the appropriation represents an upper limit only for the expenditure, and there is no obligation attached to it. The legislature is providing a permission to spend, rather than extracting a promise of spending.

The relevance of these distinctions is demonstrated by the chart below showing a possible interpretation of the proposed standards.



Such an interpretation relies on a number of judgements that are not well teased out in the ED.

The first is that if the appropriation is a promise to the reporting entity, then the reporting entity has control of an asset that can be drawn on, but if the reporting entity has permission, that does not amount to control of an asset as that permission is controlled by other parties. This conclusion may be dependent on jurisdictional practice, and the role and authority of the President or Cabinet Ministers, for example to halt or defer expenditure, or to reallocate resources.

The second is that appropriations for expenditure specify the purpose of the expenditure in sufficient detail that the goods or services (or the bundle or series of goods or services) promised are sufficiently “distinct” that it can be determined when control of the goods or services are transferred to the customer. It may be that this test is not met, and the appropriation promise merely creates a “present obligation” to incur costs.

The above discussion has been provided to demonstrate the practical issues that would be encountered if ED 71 is issued in its current form, and the inadequacy of the current guidance to ensure that a consistent approach is taken and that financial statement prepared under IPSAS will be comparable.

## ED 72 Transfer Expenses

### 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 boundaries between the scope of ED 72 and related IPSAS standards, such as IPSAS 42 *Social Benefits*, and IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* is not clear. Guidance or illustrative examples on this issue may be helpful. The Treasury also notes that the definition of transfer expenses in ED 72 does not address the extent to which the transfer provider's overhead expenses should be attributed.

### 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?

Agree, but Treasury views the distinction between transfer expenses with and without performance obligations as sometimes being difficult to apply in practice. Further guidance or illustrative examples on this issue would be helpful.

### 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?

Disagree. The transfer provider may apply a number of monitoring regimes, not all of which will necessarily directly provide evidence of satisfaction of the transfer recipient's performance obligations. Such monitoring arrangements may focus on outcomes rather than the outputs delivered by the transferee, may focus on governance and capability arrangements, or may rely on other assurance or reporting-by-exception arrangements. Such monitoring regimes should not prevent the transfer provider reporting a transfer expense with performance obligations.

### 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?

The NZ Treasury broadly agrees with the proposed measurement requirements for transfer expenses with performance obligations. However we do not think the interaction with IPSAS 19 is clear and may lead to inconsistent reporting.

**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.

In light of our response to SMC 3, we have not answered this question.

**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?

The NZ Treasury agrees.

**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?

The NZ Treasury notes that under the proposals, symmetry may not occur in practice for a number of reasons, such as different judgements by transferor and transferee about the existence and satisfaction of performance obligations or different financial reporting dates.

The NZ Treasury notes that non-symmetrical arrangements do mean that additional costs are incurred, and therefore, other things being equal, should be an objective of the standard. Where this is not achieved, the onus is on the standard setter to show that there are benefits that exceed the costs.

**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?

The NZ Treasury agrees that transfer provider needs to consider the impact of appropriations as to whether it has a present obligation to transfer resources, and should therefore recognize a liability. However, the discussion and guidance on this issue is inadequate. The necessary guidance could drive off the discussion on Other Matters for Comment on ED 71 included in this submission.

**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?

As per our response to SMC 6 on ED 71, the Treasury notes that the proposed the disclosure requirements may be detailed and onerous, particularly at the level of individual agencies.

Treasury regrets that the disclosure requirements have been adapted from the requirements in ED 70, rather than specifically considering what information and why, users would value regarding the entities use (and non-use) of funding provided to it. We recommend that IPSASB revisits these requirements on a first principles basis, applying the principles in Chapter 7 of the Conceptual Framework.



