

23 September 2020

Ian Carruthers, Chair  
International Public Sector Accounting Standards Board

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Dear Ian

### **Auckland Council Submission to IPSASB Exposure Drafts and Consultation Papers**

Thank you for the opportunity to comment on the IPSASB Exposure Drafts and consultation papers relating to revenue and transfer expenses.

Auckland Council is Australasia's largest local government entity and is made up of the council and six substantive council-controlled organisations. We invest heavily in infrastructure and many of our decisions will have a fiscal impact on Auckland's future generations.

We have given our responses to the specific questions for the respondents as in appendices to this letter along with our additional comments for the IPSASB's consideration.

We hope our responses and comments are helpful in aiding your decision-making process. Should you have any queries relating to the responses, please do not hesitate to contact Alvin Ang at the details provided below.

Yours sincerely



John Bishop

Group Treasurer

**AUCKLAND COUNCIL**

+64 9 977 6598

[john.bishop@aucklandcouncil.govt.nz](mailto:john.bishop@aucklandcouncil.govt.nz)



Tsu Chun Ang (Alvin)

Senior Group Reporting Technical Accountant

**AUCKLAND COUNCIL**

+64 21 196 2639

[alvin.ang@aucklandcouncil.govt.nz](mailto:alvin.ang@aucklandcouncil.govt.nz)

## Appendix 1 – Response to ED70 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?

We agree that the scope is clear. However, we believe more consideration should be given to the relevance of IFRS 15 wordings in PBE context. The ED is heavily based on IFRS 15 and therefore the recognition criteria have a focus on revenue from contracts. For example, paragraph 8 requires all the criteria from (a) to (e) to be met in the identification of a binding arrangement.

Paragraph 8(a) states:

The parties to the binding arrangement have approved the binding arrangement (in writing, orally or in accordance with other customary practices) and are committed to perform their respective obligations.

While AG11. States:

Binding arrangements can be evidenced in several ways. A binding arrangement is often, but not always, in writing, in the form of a contract or documented discussions between the parties. The binding arrangement may arise from legal contracts or through other equivalent means such as statutory mechanisms (for example, through legislative or executive authority and/or cabinet or ministerial directives).

It could be possible for a situation to arise where not all parties approve the binding arrangement that arises from a statutory mechanism. The examples mentioned in AG11 are likely to require approval only from the party issuing legislative or executive authority and/or cabinet or ministerial directives. Therefore, this could contradict the requirement set out in paragraph 8(a). We recommend IPSASB to consider the relevance of wordings from IFRS 15 to PBEs.

## Appendix 1 – Response to ED70 Revenue with Performance Obligations (Continued)

### 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 IPSASB’s decision. The reasons are well explained in BC20 – BC22.

### 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?

Yes. We agree with the application guidance. The suggested price allocation method is reasonable by first allocating the price to the component that is related to the transfer of the promised goods or services with the remainder being accounted for as revenue without performance obligations.

However, very often in the public sector, there could be instances where an arrangement contains both components (i.e. a service and achieving certain objectives) and there is no reference in the market to determine the transaction price of that specific service. We suggest that further guidance is included on how preparers can determine the transaction price of the service component.

### 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. From Auckland Council’s perspective, we believe the disclosure requirements should be aligned with those in IFRS 15. This is because Auckland Council is a mixed group entity and a debt issuer in three different markets. The alignment with IFRS 15 would ensure better consistency of information disclosed in the financial statements, which would be useful for investors to make investment decisions when comparing our financials with other potential investees.

## **Appendix 1 – Response to ED70 Revenue with Performance Obligations (Continued)**

### **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 decision. We believe this situation is also likely to happen among the public sector entities and we consider the requirements set out in paragraph 120 to be adequate.

## Appendix 2 – Response to ED71 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?

We do not agree with the proposal outline in SMC1. We find it difficult to distinguish between specified activities and eligible expenditure. We are also unsure of the purpose of distinguishing a specified activity and eligible expenditure.

Paragraph 18 of the ED gives examples of constructing a hospital and conducting research as types of specified activities. Paragraph 19 mentions that the transfer recipient is unable to avoid outflow of resources as it is required to use the transfer in the delivery of the specified activity or return the resources to the transfer provider, or incur another form of redress. We cannot clearly tell the difference between "outflow of resources" relating to a specified activity mentioned in paragraph 19 and "eligible expenditure" defined in paragraph 20 and 21.

This reason for the confusion is because the outflow of resources relating to a specified activity would also fit into the definition of an eligible expenditure.

A practical example that we can give in Auckland Council's context is a receipt of funding to hold art exhibitions for local artists. Assume that we received a grant funding of \$2 million from a local trust to hold art exhibitions at Auckland Art Gallery to display artworks created by local artists. In order to hold the exhibitions, we would incur expenses such as venue hires, artwork leasing and event promotion. The exhibitions held would qualify as specified activities and the relating expenses incurred would also qualify as eligible expenditure.

We believe a present obligation arises ONLY when the transfer recipient is obligated to return the resources to the transfer provider if the conditions attached to the binding arrangements are not met.

## Appendix 2 – Response to ED71 Revenue without Performance Obligations (Continued)

### 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?

We agree that the flowchart clearly illustrates the process, however, we think the box that includes “Use [draft] IPSAS [X] (ED 71) Revenue without Performance Obligations Are there other present obligations related to the inflow? (Paragraph 47-50)” could be split into two boxes i.e. *Are there other present obligations related to the inflow? (Paragraph 47-50)- Yes/No*, then Yes = “Use [draft] IPSAS [X] (ED 71) Revenue without Performance Obligations”.

### 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?

We agree that “point in time” and “over time” basically covers most scenarios. However, we believe it would be beneficial to include guidance on how these should be applied. Paragraph 58 of ED70 states that a transfer recipient shall determine at inception whether it satisfies the present obligation over time or at a point in time. If the transfer recipient does not satisfy a present obligation over time, the present obligation is satisfied at a point in time. There is no guidance on how the determination should be made.

We believe the inclusion of the following suggested guidance could enhance the clarity of the principles.

#### Over time

Revenue without performance obligations is recognised over time when present obligations from a binding arrangement are satisfied over an agreed period.

#### At a point in time

Revenue without performance obligations is recognised at a point in time when present obligations from a binding arrangement are satisfied based on occurrence of an incident/s or a condition/s which were mutually agreed.

## **Appendix 2 – Response to ED71 Revenue without Performance Obligations (Continued)**

### **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?

We do not agree that the guidance is sufficient. We agree with the ED's concept of allocating the transaction price to each present obligation. However, it is not clear how this should be done. In the public sector, it is common that an arrangement may have multiple present obligations and it could therefore be challenging to assign a price to each of them. This may result in preparers using substantially different methods to allocate transaction prices and could create inconsistencies in accounting treatment and mat diminish comparability of financial statements between similar entities.

### **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 agree that receivables within the scope of this ED should be subsequently measured in accordance with IPSAS 41.

## **Appendix 2 – Response to ED71 Revenue without Performance Obligations (Continued)**

### **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?

We are of the view that there are too many disclosures required by the standard and in our view, these should be reduced. We believe there is room for improvement in the disclosure requirements of this ED.

#### Disclosures that are relevant

We believe paragraph 128, 129 and 130 are relevant. The following requirements should only be required if material to the specific entity's financial statements - paragraph 131 to 154.

#### Disclosures that can be improved

##### *Paragraph 127(b)*

This paragraph requires transfer recipient to disclose significant judgements and its changes in applying this standard. As mentioned in our response to SMC 3 and 4, the level of guidance in this ED is insufficient and allows the preparers a high level of discretion in choosing the methods to be used in recognising and measuring revenue without performance obligation.

We believe exercising judgement should be kept to the minimum in revenue recognition and measurement as this would create inconsistencies in accounting treatment and is expected to diminish comparability of financial statements among similar entities. Further, when judgements are changed, this may result in fluctuations to the statement of financial performance between different years, which decreases the reliability and comparability of information disclosed in the financial statements.

##### *Paragraph 134*

This paragraph requires the preparer to disclose the impact of present obligations that impose limits on the use of assets. These are impacts which affect the operations of the transfer recipient to assist users in making judgements about the ability of the transfer recipient to use its assets at its own discretion. This appears to contradict with the definition of an asset. Paragraph 7 of PBE IPSAS 1 states that assets are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity. If the limits on the use of assets are so significant that it impacts an entity's operation, then it may be possible that the entity does not control the asset.

##### *Paragraph 140(b), 143*

It seems like the requirements in these paragraphs are taken directly from IFRS 15.

140(b) - It requires the preparer to separately disclose impairment losses from revenue of other arrangements on receivables arising from transfers with present obligation. From a user's perspective, we are unsure of how the inclusion of this requirement will help them in making judgements. The recoverability of receivables is subject to the same impairment requirement in IPSAS 41 regardless of whether the receivables are from revenue with or without performance obligations.

143 – Similar to our points above, we are unsure of how the inclusion of opening and closing balances of receivables, the disclosure of different revenue types in (b) and (c) will help the users in making judgements. We can understand the inclusion of these requirement for the for-profit entities as their common objective is to increase revenue and ultimately create value for their shareholders. As such, disclosure of this information at the revenue stream level would allow users to evaluate the performance and the future value of the entity. However, entities in the public sector are not revenue focussed and therefore we do not see the relevance of this requirement.

*Paragraph 132(a), 144 & 146 – Duplication of similar requirement*

Paragraph 132(a) requires the preparer to disclose the accounting policies adopted for the recognition of revenue from transactions without performance. Paragraph 144 and 146 contain the same requirement to explain timing of satisfaction of its present obligation. We are of the view that the accounting policy should include an explanation of the revenue recognition method.

*Paragraph 147*

This paragraph relates to revenue from taxes and fines and the counterparty may not have the ability or intention to pay.

We believe it would be extremely challenging to determine whether all our counterparties have the ability or intention to pay their rates or fines. We are also unsure of how the inclusion of this disclosure will be useful to the users. For taxation revenue, the counterparty should have the ability to pay if they can earn an amount to be taxed. For fines, the purpose of having fines is to curb the incidence of offences.

If we factor an implicit price concession into the consideration of revenue, this could send the wrong message to tax debtors and offenders that the authority allows leniency in receiving payments.

From a practical point of view, the situation for taxes and fines are dissimilar to transactions where discounts or credits are given. There is insufficient guidance in the standard on how the transfer recipient reliably estimates the expected value or the most likely amount that they will receive.

Further, the application of paragraph 66 and 67 seems to duplicate the requirement of IPSAS 41 in estimating the expected credit loss. Paragraph 67 requires a transfer recipient to estimate an amount of variable inflows. This would create another area subject to judgement, which contributes to a lower degree of reliability of financial statements produced.

*Paragraph 152 and 153 – Determining the timing of Satisfaction of Present Obligations*

Similar to paragraph 144 & 146 above, the requirement to disclose methods used to recognise revenue is a duplicate of the requirement to disclose accounting policy. We suggest that paragraph 132(a) is expanded to include the methods.

## Appendix 2 – Response to ED71 Revenue without Performance Obligations (Continued)

### 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?

We are of the opinion that the ED still requires further development. It appears that the recognition and measurement requirements were taken from IPSAS 23 and disclosure and presentation from IFRS 15. We have summarised our findings as below.

#### Lack of guidance and increased use of judgements in making estimation

We agree broadly on the structure and principles. However, we find that there is very little guidance on how the principles should be executed in practice, which could be the reason for the large number of areas that requires preparers to exercise judgements in making estimations. In our view, we believe a good accounting standard should provide clear direction and sufficient guidance on how transactions should be accounted for with an aim to reduce the subjectivity from exercising judgements.

#### Duplication of requirements

We also identified a couple of areas that are potentially duplicating each other. We suggest the Board review the ED for succinctness of the text in order to keep messaging consistent and enhance the understandability of the document.

#### Overlapping with other standards

We also noticed that a couple of overlaps in the requirements with other accounting standards, especially with the impairment requirements in IPSAS 41 *Financial Instruments*. We suggest the Board makes reference where possible to other accounting standards to avoid possible duplication.

## **Appendix 3 – Response to ED72 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?

We agree that the scope of this draft is clear.

### **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. This would ensure consistency in accounting treatment for both parties recording revenue and expense.

### **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?

We are of the view that monitoring alone is not sufficient. Our suggestion is unless a transfer recipient is obligated to confirm the satisfaction of performance obligations to the transfer provider throughout the duration of the binding arrangement, the transaction should be accounted for as a transfer expense without performance obligations.

## Appendix 3 – Response to ED72 Transfer Expenses (Continued)

### 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 agree with the recognition and measure requirements for transfer expenses with performance obligations.

### Comments on Basis for Conclusions

BC23. The IPSASB noted that the asset could not be the resources transferred, or the right to have those resources returned, as at the point the liability is recognised, the resources have been transferred.

We find BC23 difficult to understand and the statement is in conflict with BC21. It was explained that a liability is recognised if the transfer provider had not transferred the resources.

### 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 believe it would be difficult for the transfer provider to monitor the satisfaction of performance obligations. This can only be done when the transfer recipient also commits to a process for both parties agree when a performance obligation is satisfactorily met.

If the transfer provider cannot reliably ascertain the satisfaction of performance obligations of a binding arrangement, then it would make the application Public Sector Performance Obligation Approach (PSPOA) difficult.

As mentioned in our response to SMC 3, we are of the view that monitoring alone is not sufficient. The transfer recipient should be contractually obligated to confirm the satisfactory performance of the obligations to the transfer provider throughout the duration of the binding arrangement.

## Appendix 3 – Response to ED72 Transfer Expenses (Continued)

### 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 agree with the recognition and measurement requirements for transfer expenses without performance obligations.

### 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 recognises revenue.

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

We agree that the lack of symmetry is appropriate. ED 71 requires a transfer recipient to recognise revenue as it satisfies the related present obligations. However, it is impractical from the transfer provider's perspective to do the same unless the transfer recipient confirms the satisfaction present obligations to the transfer provider.

## **Appendix 3 – Response to ED72 Transfer Expenses (Continued)**

### **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 do not have any objection against this proposal, however we note that it is not applicable to Auckland Council Group.

### **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?

We do not agree that the disclosure requirements in this ED are appropriate and we are unsure if it is a good decision to mirror the requirements in ED70 and ED71 as the disclosure are heavily based on IFRS 15 Revenue from Contracts with Customers. These requirements contain excessive amounts of detail that are useful for for-profit sector entities, but may not be relevant to public sector entities.

Paragraph 132 requires the transfer provider to disclose any impairment losses recognised in accordance with IPSAS 21 on any transfer provider's binding arrangement assets (i.e., rights to have goods or services transferred to a third-party beneficiary), which the transfer provider shall disclose separately from other impairment losses from other binding arrangements. We do not believe this requirement is necessary because these assets are different from a normal receivable where we expect to recover the amount owing.

We noticed that majority of the issues identified in our response to ED71's disclosure requirements are applicable to this ED as well. We suggest the Board to refer to our response to SMC 6 and SMC 7 of ED71 for the unnecessary requirements.