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15 January 2018

Dear Sir/Madam

**COMMENT ON CONSULTATION PAPER: ACCOUNTING FOR REVENUE
AND NON-EXCHANGE EXPENSES**

The Technical Director

International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto, Ontario M5V 3H2 Canada

We welcome the opportunity to comment on Consultation Paper: *Accounting for Revenue and Non-Exchange Expenses*.


The Consultation Paper, *Accounting for Revenue and Non-Exchange Expenses*, aims to address the gaps in literature and difficulties with applying the current requirements, as well as improve accounting for revenue and potential requirements and guidance for accounting for non-exchange expenses.

In part, we are supportive of the IPSASB's Consultation Paper: *Accounting for Revenue and Non-Exchange Expenses* but there are instances where we disagree with the IPSASB. Our responses to the preliminary views and specific matters for comment are listed below.

Please feel free to contact me should you have any queries relating to this letter.

Yours sincerely

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KPMG Services Proprietary Limited is not a Registered Auditor in terms of the Auditing Profession Act, 26 of 2005 and does not provide audit services as defined in Section 1 of this Act.

Registration number 1999/012876/07

Chief Executive: N Dlomu
Directors: Full list on website

The company's principal place of business is at KPMG Crescent, 85 Empire Road, Parktown, where a list of the directors' names is available for inspection.

PRELIMINARY VIEWS & SPECIFIC MATTERS FOR COMMENT

Preliminary View 1 – Chapter 3.8

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

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

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

We agree that an IPSAS primarily based on IFRS 15 should be developed for revenue from exchange transactions and construction contracts, thereby addressing Category C transactions. It is always important for the IPSASB to mirror the requirements of IFRS for transactions that are similar for the public and private sectors.

We recommend that the proposed IPSAS take into consideration and address the complexities around the accounting of transactions with multiple goods and services in a single contract, identifying distinct goods and services, and the treatment of variable consideration.

It is not always clear whether collection of consideration is considered probable in the public sector, which is a requirement for a contract to exist. Guidance for such transactions should be provided in the proposed IPSAS.

We recommend that the standard clearly address how the IFRS 15 model will apply to construction contracts currently in the scope of IPSAS 11, specifically on the timing of revenue recognition based on how performance obligations are defined in a contract. The Consultation Paper (CP) appeared to focus on IPSAS 9 transactions.

Preliminary View 2 – Chapter 3.9

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

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

We agree that an updated IPSAS 23 should address Category A revenue transactions that do not contain any performance obligations or stipulations. If there is more than one standard there will be possible scope and definitional issues and it may also not meet the objectives the IPSASB set for this project (i.e. to eliminate the exchange vs non-exchange distinction). As a result, we recommend the IPSASB to update IPSAS 23 to maintain the important principles in IPSAS 23.

We suggest that clear guidance be provided on the accounting for these Category A revenue transactions. For instance, if there are no performance obligations then revenue should be

recognised when it is received or receivable. Further, if there are no performance obligations/stipulations then disclosures only are likely to be impacted. It would be ideal that all revenue is addressed in a single standard using the same principles – although we acknowledge that practically it may be difficult to cover both IFRS 15 transactions and “non-exchange” transactions in a single standard.

Specific Matter for Comment 1 – Chapter 3.10:

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

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

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

We are not aware of any issues in applying IPSAS 23 other than those which were identified by the IPSASB in the CP and the potential issues in the accounting approach for transactions with no performance obligations or stipulations.

Preliminary View 3 – Chapter 4.64:

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

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

In principle, the performance obligation approach is plausible. However, we disagree with IPSASB's Preliminary View to account for Category B transactions using the Public Sector Performance Obligation Approach (PSPOA) as this is a modified form of the IFRS 15 five-step revenue recognition approach, which already comes with a lot of complexities especially in identifying the appropriate elements of the five-step requirements. Further, a number of uncertainties exist regarding the approach. For instance, it is unclear whether the PSPOA will provide the necessary information to meet the objectives of financial reporting for the public sector. In practice there may be some challenges in identifying whether an arrangement is enforceable or whether there is a performance obligation – these could be addressed through the inclusion of examples. There will always be a requirement for judgment to be exercised. Par. 4.25 - 27 of the CP sets out some of the challenges with the PSPOA. These are valid challenges, however, these appear to relate to the nature of the arrangements, rather than the accounting principles.

We therefore suggest that an updated IPSAS 23 be applied to account for the Category B transactions instead of the PSPOA, although it is worthwhile exploring in more detail how the PSPOA could be adapted for the public sector.

Specific Matter for Comment 2 – Chapter 4.64:

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

- Step 1 - Identify the binding arrangement (paragraphs 4.29 - 4.35);*
- Step 2 - Identify the performance obligation (paragraphs 4.36 - 4.46);*
- Step 3 - Determine the consideration (paragraphs 4.47 - 4.50);*
- Step 4 - Allocate the consideration (paragraphs 4.51 - 4.54); and*
- Step 5 - Recognize revenue (paragraphs 4.55 - 4.58).*

Do you agree with the proposals on how each of the IFRS 15 five-steps could be broadened? If not, please explain your reasons.

We mostly agree with the proposed broadening of the IFRS 15 five-steps as the requirements are more specific to the public sector. However, clear and extensive guidance must be provided in each of the steps because currently the five-steps are complex and may lead to more ambiguity in application.

Specific Matter for Comment 3 – Chapter 4.64:

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

- (a) Option (b) - Require enhanced display/disclosure;*
- (b) Option (c) - Classify time requirements as a condition;*
- (c) Option (d) - Classify transfers with time requirements as other obligations; or*
- (d) Option (e) - Recognize transfers with time requirements in net assets/equity and recycle through the statement of financial performance.*

Please explain your reasons.

We favour Option (e) - *Recognize transfers with time requirements in net assets/equity and recycle through the statement of financial performance* because this is in line with the IPSASB Conceptual Framework and addresses most of the current issues (as shown on the matrices). This option also allows for revenue recognition over more than one reporting period. In accordance with par. 4.7 of the CP, resources transferred without conditions prior to the reporting period for which they are intended to be used (i.e. those with just time requirements) give rise to revenue at the point at which they are receivable and the recipient controls those resources. This may result in undesirable accounting outcomes. The IPSASB would thus have to consider the different jurisdictions as the requirements may not be the same, as well as the expectation from these transactions i.e. explain the time requirements further.

Specific Matter for Comment 4 – Chapter 4.64:

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

- (a) Yes*
- (b) No*

Please explain your reasons.

Yes. This will assist in eliminating the ambiguity in accounting for these Category B transactions and it will be in line with the IPSASB Conceptual Framework.

Preliminary View 4 – Chapter 5.5:

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

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

We agree that accounting for capital grants should be explicitly addressed within IPSAS as this is consistent with IFRS which has a standard specifically for grants.

Specific Matter for Comment 5 – Chapter 5.5:

(a) Has the IPSASB identified the main issues with capital grants?

If you think that there are other issues with capital grants, please identify them.

(b) Do you have any proposals for accounting for capital grants that the IPSASB should consider?

Please explain your issues and proposals.

- (a) We agree that the IPSASB has identified the main issues with capital grants.*
- (b) The IPSASB should consider providing guidance in accounting for a capital grant specific for the asset by either addressing the revenue recognition in the IPSAS or updating the Conceptual Framework.*

Specific Matter for Comment 6 – Chapter 5.9:

Do you consider that the IPSASB should:

(a) Retain the existing requirements for services in-kind, which permit, but do not require recognition of services in-kind; or

(b) Modify requirements to require services in-kind that meet the definition of an asset to be recognised in the financial statements provided that they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information; or

(c) An alternative approach.

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

We are in favour of (b) - *Modify requirements to require services in-kind that meet the definition of an asset to be recognised in the financial statements provided that they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information.* Control and value of the services was difficult to determine but with appropriate guidance to be provided in the updated IPSAS, this should no longer be an issue. The materiality or significance of the service to the entity's operations (delivering on the mandate) must also be considered. For example, guidance provided by the Accounting Standards Board (ASB) which develops the accounting standards for the public sector in South Africa recommends that service in-kind transactions that are significant and material to the operations of the entity should, under certain circumstances, be recognised in the financial statements.

Preliminary View 5 – Chapter 6.37:

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

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

We agree with the principles of the IPSASB's Preliminary View that these non-exchange transactions related to universally accessible services and collective services should be accounted for under The Extended Obligating Event Approach as this is in line with the IPSASB Conceptual Framework. That is to say, a liability should be recognised when the criteria in the Conceptual Framework are met, with the related expense. Further, an entity should recognise an asset if a condition with a return obligation exists, and once the condition is met it will be expensed. We recommend that this approach should also mirror the method to account for social benefit liabilities once the IPSASB issues the standard on Social Benefits. We, however, seek clarity on the types of transactions that the IPSASB proposes should be recognised with this approach.

Preliminary View 6 – Chapter 6.39:

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

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

We agree that resources applied for universally accessible services and collective services should be expensed as services are delivered because there is no obligating event related to these non-exchange transactions. The entity should not raise a liability if there is no present obligation to provide those services.

Preliminary View 7 – Chapter 6.42:

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

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

We disagree with the IPSASB's Preliminary View for accounting for non-exchange expenses for the reasons stated above for revenue, under Preliminary View 3. Another issue is whether the resource provider has an asset (i.e. provided funding but for which performance obligations have not been delivered). There is not much discussion in the CP about whether an asset would exist in relation to unfulfilled performance obligations or what the nature of the asset might be (i.e. prepayment or financial asset, etc.). More guidance is required on how the PSPOA for expenditure might work in principle and in practice.

Preliminary View 8 – Chapter 7.18:

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

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

We disagree with the IPSASB's Preliminary View to measure non-contractual receivables at face value with any uncollectible amount identified as an impairment on initial recognition. The approach of accounting for non-contractual receivables at face value less impairment as it is not appropriate to assume that revenue will not be collected since the entity has an obligation to collect all revenue and this would be contrary to normal business principles. The IPSASB should consider if it would be more appropriate to initially present gross revenue due to government, and reflect uncollectability as a subsequent measurement event by recognising an impairment loss i.e. any initial impairment is identified, but not recognised.

Preliminary View 9 – Chapter 7.34:

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

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

We disagree that subsequent measurement of non-contractual receivables should use the fair value approach as it could be difficult to obtain fair values for these non-contractual receivables since there is no market for them, making the fair value approach inappropriate. A user would need information about the reasons for the underlying changes in fair value, e.g. changes due to market risk, credit risk, etc. and this information is not readily available. We recommend the amortised cost approach because similar financial instruments (contractual receivables) are measured at amortised cost and these instruments are not substantially different.

Specific Matter for Comment 7 – Chapter 7.46:

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

- (a) Cost of Fulfillment Approach;*
- (b) Amortized Cost Approach;*
- (c) Hybrid Approach; or*
- (d) IPSAS 19 requirements?*

Please explain your reasons.

We support (a) - *Cost of Fulfillment Approach* as this is the amount the entity will have to pay to fulfil its obligations. The entity cannot impair its liabilities and can only record what it owes, and this approach represents the best estimate of the amount required to settle the obligation.

OTHER COMMENTS

Transitional arrangements

We recommend that the IPSASB considers including guidance on the transitional arrangements, in particular whether this will be applied prospectively or retrospectively and provide practical guidance in this regards. We also recommend the IPSASB to allow sufficient time before finalising guidance on revenue to learn lessons from the private sector, specifically regarding the implementation of IFRS 15.

Inclusion of application guidance and practical examples

Given the difficulties experienced by entities in practice to account for revenue and non-exchange expenses, we recommend that extensive application guidance and practical examples are included in any guidance developed as an outcome of this CP. Sufficient and appropriate guidance should be provided as to which of the categories revenue belongs to and ambiguity must be eliminated by providing an exhaustive list.