



EUROPEAN COMMISSION
Budget

Budget execution (general budget and EDF)
Accounting

Brussels,
BUDG.DGA.C02/MZ

Mr Ian Carruthers
Chairman
International Public Sector Accounting
Standards Board (IPSASB)

Comment letter on Consultation Paper '*Accounting on Revenue and Non-Exchange Expenses*'

Dear Mr Carruthers,

We welcome the opportunity to comment on the above mentioned Consultation Paper '*Accounting on Revenue and Non-Exchange Expenses*' ('CP'). The following comments are made in my capacity as Accounting Officer of the European Commission responsible for, amongst other tasks, the preparation of the consolidated annual accounts of the European Union, which comprise more than 50 European Agencies, Institutions and other European Bodies with an annual budget of more than EUR 140 billion.¹

We would like to thank the International Public Sector Accounting Standard Board (the 'IPSASB') for this opportunity to contribute to the due process and we are pleased to provide you with our comments with the aim of improving the transparency, relevance and comparability of the financial statements across jurisdictions.

We consider that the new IPSAS guidance on a revenues and non-exchange expenses will be very important for the public sector, as it is related to the core of the public sector activities and have a material impact on the financial statements of the public sector entities. In particular, we appreciate the IPSASB work with regard to the accounting for non-exchange expenses, for which so far no guidance was available.

The majority of the revenues of the European Commission (the 'Commission') are considered non-exchange revenues as they relate to the contributions from Member States to the EU Budget. Similarly, grants and other transfers provided to beneficiaries constitute the most significant item of EU expenditure, allowing the EU to pursue its objectives. Therefore, the Commission has developed its own accounting rules on the treatment of grants.

Regarding the proposals put forward in the CP, we agree with the IPSASB's approach to converge public sector accounting standards for exchange revenues with the

¹ For the sake of clarity, the views presented in this comment letter do not represent the views of the EU Member States, or the views of the European Public Sector Accounting Standards ('EPSAS') Task Force, and are without prejudice to future decisions which may be taken in the context of the EPSAS project.

model used in the private sector (IFRS Standards) while adding public sector specific guidance and illustrative examples. We are also supportive to the extension of the 'performance obligation approach' to the public sector specific transactions which include such performance obligations. Finally, with regard to the treatment of public sector expenditure, we favour the 'reversed public-sector performance obligation approach'.

We consider that these proposals would allow for better reflection in the financial statements of the public sector entities of their activities. In particular, the stage of implementation of the performance obligations by public sector entities on one side (revenues), and the progress of the activities financed by the public sector entity on the other side (expenses), provides very relevant information for the users of financial statements. Due to the fact that resources are limited, we consider that there is an increased need to look closer at performance and achievement of results expected from the actions financed by the public sector. This is of high importance for strong public financial management. As such, we consider that the proposed accounting treatment of the public-sector expenses and revenues would increase usefulness of the financial statements by providing valuable input both for the decision making processes (allocation of the budget) and for the accountability in the public sector (effectiveness of the use of resources).

While being overall supportive to the IPSASB preliminary views on the above-mentioned subjects, we believe that it is very important to clearly define which public sector transactions would fall under such an approach, as a very narrow – close to private sector – classification, could restrict the transactions in the scope and as such limit the usefulness and the advantages of the proposed treatments. Therefore we appreciate the IPSASB proposals in the CP to extend the guidance of IFRS 15 '*Revenue from contracts with customers*' to activities common to the public sector.

Please find our detailed responses to the questions in the CP in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact me. In particular, the Commission is available to provide some examples of different types of our grants as an input for further IPSASB work on the new/updated standards.

Yours sincerely,



Rosa ALDEA BUSQUETS

cc: Derek Dunphy, Martin Koehler, Bruno Gomes, Mihaela Bularca, Magdalena Zogala (DG.BUDG.C2), Alexandre Makaronidis (ESTAT.C.TF.EPSAS)

Appendix – Response to the questions raised in the CP

Question (Preliminary view 1) – Replace current IPSAS dealing with revenue based on the requirements of IFRS 15 (Category C)

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.

Response

We agree with the proposal to align the IPSAS accounting treatment with IFRS 15 requirements for similar transactions within the public sector, which involve delivery of goods and services under contracts with customers. We also agree that there is a need for some limited modifications to make the IFRS 15's five-step model applicable in the public sector. In addition, it would be useful to consider the experience already gained by the private sector in the implementation, in order to possibly include additional guidance or clarifications in the future IPSAS standard.

Question (Preliminary view 2) – Recognition of revenue for transactions that do not contain any performance obligations or stipulations (Category A)

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.

Response

We agree that the non-exchange revenue transactions, which do not include any performance obligation nor stipulations, should be out of scope of the performance obligation approach, as their accounting under such an approach would not be relevant. Therefore we support the proposal to include guidance for these transactions under an updated IPSAS 23. We understand that the general rules would then stay unchanged, with additional guidance potentially to be provided in the areas identified as causing problems in implementation.

Question (Specific Matter for Comment 1) – Issues encountered in applying IPSAS 23

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.*

Response

The EC has not identified any specific issue in applying IPSAS 23, besides those already identified by the IPSASB in the CP.

Question (Preliminary View 3) – Accounting for Category B transactions

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.

Response

We support the IPSASB preliminary view 3 ('PV') that the transactions in category B should be accounted for using the Public Sector Performance Obligation Approach ('PSPOA'). As indicated in our comment letter, we considered it relevant to link the recognition of revenue by the public sector entity to the performance (fulfilment) of the obligations related to that revenue. We believe that it will provide useful information for the users regarding the use of resources provided and - in longer terms - it should positively impact the public sector management in general.

We also support IPSASB approach that for transactions, which do not have all features of commercial transactions in the private sector, important public sector adaptations would be needed, as further discussed under the Specific Matter for Comment ('SMC') 2. In particular, it would be very important to consider clarifying the type of transactions that should be considered relevant for the proposed treatment. If the criteria would be very restrictive, then the applicability of the new approach in the public sector would be minimal and the costs of implementation of the new approach (development of the new standard, review of all contracts) may outweigh benefits.

Regarding Category B, we understand that there may still be situations of revenue transactions where there is a condition linked to the revenue, but the transaction does not qualify for the PSPOA. In our current understanding of the IPSASB proposal, such transactions would fall under the amended IPSAS 23, and (also depending on final adaptations) would still be accounted for as liabilities until the conditions are met. As this will then lead to a similar accounting treatment to the performance obligation approach, we would suggest considering whether each contract with conditions does not implicitly include performance obligation and as such could qualify for the PSPOA. Furthermore, we believe that in order to avoid inconsistencies, it should be clarified in the standard that in case there is both a performance obligation and a stipulation in the binding arrangement, the performance obligation approach prevails.

Question (Specific Matter for Comment 2) – Proposal to broadening the requirements in the IFRS 15 five-step approach for the public sector

The IPSASB has proposed broadening the requirements in the IFRS 15 five-step approach to facilitate applying a performance obligation 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 (paragraph 4.36 – 4.46);

Step 3 – Determine the consideration (paragraphs 4.47 – 4.50)

Step 4 – Allocate the consideration (paragraph 4.51 – 4.54); and

Step 5 – Recognise revenue (paragraphs 4.55 – 4.58).

Do you agree with the proposals on how each of the IFRS 15 five-step model could be broadened?

If not, please explain your reasons.

Response

We fully agree that the IFRS 15 approach would need to be broadened / adapted to be applicable to the transactions with performance obligation which however do not have all features of a commercial transaction specific for the private sector. As raised in our reply to the PV2, it will be crucial for the new standard to define which transactions would be in the scope. In this context we would like to raise the following points:

Enforceability - We agree with the IPSASB approach taken in point 4.32 of the CP to extend the enforceability to different ways the transferor of resources can take remedies in the event of non-fulfilment of performance obligation. We believe that it should be considered for the future IPSAS to which extend the funds providers would need to be able to enforce performance of the contract i.e. fulfilment of the agreed action. In many cases, even if the performance of the action is contractually agreed (as an obligation of the beneficiary), the enforcement rights of the funds provider can - in practice - be limited to the recovery of funds provided in advance or to non-providing of subsequent financing. In our view such condition should be considered as sufficient for the performance obligation approach (in line with the 'Multi-research grant' example in the CP), in order not to limit the transactions in the scope. Otherwise there could be many transactions, which include conditions, but which would be out of scope due to lack of enforceability of the performance of the service (action). In the Commission context, the grants include an obligation of the resource recipient to perform an agreed action or to implement the work programme (in the Commission's grant agreements it is stated that the beneficiary 'agrees to implement the action'), and the beneficiaries of the funds are required to report on the progress. The Commission has right to limit the funding (or recover the funds already provided) in case the action stipulated in the grant agreement has not been implemented properly (i.e. it has not been implemented or has been implemented poorly, partially or late).

Identification of a customer - We agree with the IPSASB view in point 4.34 of the CP that the three party agreements are common in the public sector and that the PSPOA should be applicable in cases when the fund provider is not a direct recipient of the goods/services delivered under the action. However, the action implemented by the fund recipient provides benefits to the fund provider in terms of meeting of its policy objectives. Furthermore, we notice that in many cases identification of the final customer would not be possible, as this could be an unidentified group of people or general public (e.g. the outcome of a grant given for the research is expected to benefit the general public, as it supports innovation and development of the economy).

Performance obligation - With reference to point 4.45 of the CP, we would suggest to consider if the requirement to use the revenues for the defined set of activities of a public sector entity could be considered as a performance obligation in cases where other criteria would be met (e.g. enforceability). This could be viewed from the perspective discussed under point 4.34 of the CP that the activities of the fund recipient are financed by the fund provider because they contribute to the funds provider's objectives, regardless of the fact that the direct transfer of distinct services to beneficiaries might not be clearly identifiable. An example could be an operational grant provided by the Commission for the implementation of an agreed specified work programme. Implementation of the work programme could be considered as provision of service to the society. It could be further considered,

whether implementation of the budget should be seen as performance obligation of public sector entities, given the fact that the budget usually defines the areas for which money should be spent (i.e. it broadly defines services to be provided to certain groups of the society).

Allocation of consideration – We support the IPSASB view presented in the point 4.54 of the CP that in the public sector context the focus should rather be on ability to determine the cost of fulfilling of each performance obligation rather than on selling price. In the Commission context, the grants are often provided on the basis of costs incurred/to be incurred for the agreed action.

Question (Specific Matter for Comment 3) – Whether is appropriate to consider *time requirement* within IPSAS 23

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

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

Please explain your reasons.

Response

In our view, if there is no condition neither a performance obligation linked to the revenues received by an entity (i.e. the fund provider has no means to enforce performance or to recover the money) such revenue should be recognised in the statement of financial performance when received or receivable. We believe that in such case there is no liability linked to the revenues received and as such we do not support option c neither option d. The issue of the link to the future periods (the revenue is supposed to be spent in the next periods) could be solved by an appropriate disclosure (note to the financial statements) as proposed under **option (b)**. We would however not support a different presentation in the statement of financial performance – disaggregation of revenue – as in our view it could create confusion and would impair understandability of the financial statements. We are also not supportive for option e, as it would increase complexity and may be difficult to understand for the readers of the financial statements. In general, we believe that the allocation of revenues between the P&L and deferrals could be too discretionary in cases when there is no legal obligation (no enforceability, no performance obligation) and this could impact reliability. We suppose that there could be cases of quicker or slower implementation comparing to the provisions of the transfer agreements.

However, in our view, implementation of the PSOAP should resolve the problem of the grants with time requirements in many cases. As indicated in our previous replies, we would suggest reflecting on whether budget implementation and operating grants fulfilment of a work program under operating grants could be considered as performance obligations. In both cases revenues would be linked to the periods in which the actions are to be implemented, which could help to further solve the issue.

Question (Specific Matter for Comment 4) – whether IPSASB should provide more guidance on the distinction of exchange and non-exchange transactions

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.

Response

While we consider that provision of additional guidance for the split between exchange-non exchange transactions could be useful, we agree with the IPSASB that it needs to stay principle-based. Too prescriptive definitions may reduce relevance of the classification in some cases.

However we do not consider that the option (b) – as favoured by us for the contracts with sole time requirements - would need to be used in combination with extended guidance of exchange vs non-exchange classification. We believe that in cases the PSPOA would be followed, and depending on the scope of the transaction to which it would apply (see our previous comments) the exchange-non exchange split would lose on relevance. In particular, for the issue of time requirements, we would consider more useful to consider whether such contracts include or not a performance obligation.

Question (Preliminary View 4) – Accounting treatment of capital grants

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

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

Response

We agree with the IPSAB proposal to explicitly address accounting for capital grants in the IPSAS. This is a very common transaction in the public sector and clarifying the accounting treatment would limit diversity in practice and increase comparability of financial statements.

Question (Specific Matter for Comment 5) – Issues and/or proposals for the accounting of capital grants

(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.

Response

For capital grants, we have not encountered other issues than the ones already identified by the IPSASB. Neither a specific accounting policy has been developed under the EU Accounting Rules for revenue recognition related to the capital grants, since the Commission is in such cases rather a fund provider than a beneficiary. For the expense side, we apply the same accounting policy as for other grants, i.e. we

recognise expenses on the basis of eligible costs incurred by the beneficiaries for the action. This is considered as a good proxy for the stage of completion, as our grants are limited to the cost of implementation. In our view the stage of completion can be assimilated with the fulfilment of performance obligation by the beneficiary.

Question (Specific Matter for Comment 6) – Accounting treatment of services in-kind

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 favour on alternative approach please identify that approach and explain it.

Response

We consider that services-in kind should be accounted for in the financial statements of an entity if they are material for its operations and therefore we support the proposal under **option b**. This would allow for better reflection of costs of services provided by that public sector entity. In some cases reception of services in kind may be crucial for the entity to operate and to be able to fulfil its mission.

For example, in the EU context, we set up several joint undertakings with the private sector. While the Commission contributes to the operations of those entities with financial contribution, the industry counterpart provides its part of the agreed contribution mainly in-kind. As such, the 'in-kind' contributions of industry are the key feature of that arrangement, and are necessary for the operating activities of the entity.

We also agree with the IPSASB that it might not always be possible to reliably estimate the amounts of in-kind contributions. In such cases, the recognition criteria would not be met and the revenue should not be accounted for. Furthermore, there could be high cost related to the measurement of in-kind contributions. However, if the recognition of in-kind contributions will be applied where the in-kind contributions are significant for the entity, the benefits should outweigh the cost. Indeed under IPSAS the proposed accounting treatment would be only mandatory to be applied for material cases.

Question (Preliminary View 5) – Accounting treatment for universally accessible services and collective services

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.

Response

Yes, we agree.

Question (Preliminary View 6) – Accounting treatment for universally accessible services and collective services

The IPSASB is of the view that because there is no obligation 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.

Response

Yes, we agree.

Question (Preliminary View 7) – Accounting treatment for grants, contributions and other transfer that contain performance obligations or stipulations

The IPSASB is of the view that for 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.

Response

We support the IPSASB view to account for the expense transactions where there is a performance obligation or stipulation under the **reversed PSPOA**. As explained in our comment letter, this should allow for better reflection of the performance of the public sector entity in terms of implementation of its working programme and achievement of its objectives, which is very relevant information for the users of financial statements. We also consider appropriate that the accounting treatment on revenue and expense side of the same transaction would be aligned, i.e. the asset/liability vs revenue/expense would be recognised to the same extent in the financial statements of both entities.

We also agree on the application of the reversed PSPOA to the transactions with stipulations. In our view, in most cases a transaction, which has stipulations, should also be considered as having a performance obligation. As indicated in our replies to the PV 3 and SMC 2, it will be important to further reflect on this aspect to ensure that wide scope of transaction would qualify for the proposed approach. We understand that under the current proposal in the CP, transactions not qualifying for the reversed PSPOA (as not all criteria for the PSPOA would be met) would then be accounted for using the 'extended obligating event approach'.

In the EU context, the grants provided by the Commission in many cases foresee a commitment of the beneficiary to implement an agreed action and the beneficiary needs to provide the reports on the progress of implementation. Those reports have to be accepted by responsible operational staff before next payments or acceptance of costs. As such we consider that there is a performance obligation linked to the grant. However we also include a condition in the grant agreements, i.e. the funds which are provided as an advance-payment to the beneficiaries (so called 'pre-financing') are contractually property of the EU as long as the eligible expenses are not incurred by the beneficiary and accepted by the Commission. Until that moment the Commission can recover the amounts. The costs incurred by the beneficiaries have to be eligible (i.e. incurred in the direct linked to the agreed action), but also the action has to be implemented (see also our comment to the SMC 2).

As already indicated in our comments to the SMC 3, we would propose to consider whether the operating grants include a performance obligation. In our case, operating grants provide financial support for the functioning of certain bodies which 'are pursuing an aim of general EU interest or which have an objective forming part of, and supporting, an EU policy'. The grants are linked to the 'work programme', which has to be detailed enough to allow the Commission to monitor its implementation. As such, operating grants are not provided for the 'mere existence' of the entity but for the fulfilment of the work programme. However, as discussed under our comments to the SMC3, the identification of 'customers', i.e. recipients of the services may not always be straightforward. It might be more relevant to assume that the service is provided to the fund provider, as it helps to pursue its objectives.

Similar issue could be noted for the action grants, which are provided to beneficiaries. While direct benefits from the grant belong to the beneficiary, the grant is provided to pursue the EU policy objectives. Although the action is clearly defined in the agreement, and the Commission agrees only to cover costs incurred with the direct relation to the action ('eligible costs'), it might be difficult to identify services to be provided by the fund recipients to the fund provider or to the third parties. Therefore, if such grants would be to qualify under the reversed PSPOA, the definition of the customer or/and 'distinct goods and services' would need to be adapted, as noted by the IPSASB in the CP.

We support the public-sector modifications proposed by the IPSASB, and in particular the link to cost of fulfilment rather than to selling price. In the Commission grants, the expenses are usually related to the cost of an action incurred by the beneficiaries. The expenses are recognised in the accounts on the basis of a declaration of the costs incurred, after checking their eligibility, (i.e. link to the action) and verification of the progress of the action. If - based on the progress/implementation report - it is considered that the action is implemented as expected; the costs incurred are assumed to be the proxy of the stage of completion and constitute fulfilment of the related performance obligation.

In this context we acknowledge that the measurement of the performance obligation could be judgemental, and will require estimates. As the progress reports requested by the Commission do not include the percentage of completion, an estimation of the expenses to be recognised would be necessary.

Question (Preliminary View 8) – Measurement at initial recognition of non-contractual receivables

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.

Response

We support the IPSAB proposal for the recognition of the non-contractual receivables at face value, with the non-collectible part presented as impairment as stated in the **PV 8**. In our view this proposal will better reflect substance of the transaction and useful information will be provided to the readers of the financial statements, i.e. the amount legally due/owed by the entity (face value) from the non-exchange transaction and separately the amount considered as uncollectible. We believe that such treatment will positively impact the public financial management and increase accountability for the public sector resources.

Question (Preliminary View 9) – Subsequent measurement of non-contractual receivables

The Board 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.

Response

In consistency with our replies to PV8, we would favour **approach C**, i.e. the cost approach (face value minus impairment). This would provide relevant and understandable information for the readers of the financial statements and would be easier to implement. It would reduce the uncertainty related to the timing of the cash flows and discount rates. In our view, in the public sector context, reflection of the cost of financing in the measurement of the non-exchange receivables is not that relevant. The fact that some non-contractual receivables can be paid in the future periods may stem from the legislation and payment delay can already be taken into account in defining of face values by the legislator. As such changes of the value only due to the passage of time may not provide relevant information. Instead, it seems more appropriate to accrue interests in cases when they are contractually due, as it would be the case under approach C.

Question (Specific Matter for Comment 7) – Subsequent measurement of non-contractual payables

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

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

Please explain your reasons.

Response

We support **Approach (a)** i.e. cost of fulfilment approach. As indicated in our replies to the PV 8 and PV 9 we consider that the cost of financing has less importance, in particular as the non-contractual payables in private sector are usually short-term. Therefore we do not consider relevant to apply the effective interest rate method to such payables (as foreseen under the approaches b and c). We also consider that this approach would be more straightforward to apply and will provide understandable information.