

Task force IRSPM A&A SIG, CIGAR Network, EGPA PSG XII

Comments and suggestions considering the IPSASB document for ED 70

'Revenue with Performance Obligations'

The IPSASB has requested comments and answers to specific questions regarding its Exposure Draft (ED) 70, *Revenue with performance Obligations*. The comments and responses prepared by the Task Force IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are presented below.

The IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are three research networks that focus on Public Sector Accounting. The Task Force is made up of 17 researchers from these networks. The views expressed in this document are widely shared by the members of the Task Force, but neither do they represent the views of the whole research community represented by the networks, nor of the Institutions/Universities with which they are affiliated.

Core assumptions

We recognize the pivotal role of the IPSASB in developing high quality international public sector accounting standards to support financial reporting and to enhance non-financial disclosures by public sector entities to increase citizens' trust. We regard the development of standards and guidance on matters that are specific to the public sector as being a particularly important part of the continuing programme of work of the IPSASB. ED 70 contains proposals for a new revenue standard that would supersede IPSAS 9 *Revenue from Exchange Transactions* and IPSAS 11 *Construction Contracts*. According to this, enforceable (binding) arrangements containing performance obligations are to be accounted for under the IFRS 15-aligned ED 70. ED 70 includes additional guidance for applying the five-step public sector performance obligation approach (PSPOA).

We are of the opinion that when public sector transactions resemble those taking place in the private sector, principles and standards may be kept as aligned as possible. However, for public-sector-specific transactions, as is the case for transactions relating to *Revenue without Performance Obligations*, we are in favor of standards that are not adapted artificially from private sector accounting and we think that there is a need to seek options that best fit the public sector. This core thesis underpins our proposals and recommendations herein.

We are pleased to respond to ED 70, 71 and 72, and we take the opportunity to congratulate the IPSASB on this achievement. With these three EDs, the IPSASB has moved away from the distinction between non-exchange and exchange transactions and instead embraced revenue with (ED 70) or without (ED 71) performance obligations. ED 72 provides for the recognition and measurement of transfer expenses. In this response, we first provide some comments that relate to ED 70, 71 and 72 combined. Subsequently, we offer our views on the specific requests for comments posed by ED70.

Comments relating to ED 70, 71 and 72 combined

1. Format of the consultation

We found the questions (SMCs) to be narrow in scope, thus limiting the type of responses that we could provide. Even the layout of the consultation paper is not very helpful as the questions are grouped and presented at the beginning of the document, rather than being integrated within the consultation paper as was done previously (for example, in the Measurement consultation).

In our opinion, the EDs are too long and dishearten prospective respondents to participate. We understand that the topic being dealt with by these EDs is complicated, but we suggest that future EDs are more focused and concise.

2. Overall structure of the three EDs and the analysis of the underlying subject

Contracts or other binding arrangements can contain transactions that are with performance obligations or without performance obligations. These two streams of transactions thus need to be dealt with under separate standards.

While we agree on the distinction between transactions with and without performance obligations, we think that the three EDs provide a scattered picture about the accounting treatment of transactions. For example, (a) the recipient of revenue with a performance obligation looks at ED 70, while the provider of this revenue looks at ED 72; (b) the recipient of a grant with a present obligation or a binding arrangement looks at ED 71, while the provider looks at ED 72. This dispersed referencing may cause confusion to the user, which is not justified by the IPSASB's statement that "ED 70 should only deal with revenue so that it is in line with IFRS 15" (BC 8).

Furthermore, the respective treatment of a transaction by the two parties is not directly evident in the same standard. Compare with, for example, Leases, where the accounting by the lessee and lessor are tackled in one document. The same should be done here, for example:

- Standard 1: '*Transactions with performance obligations*' to include (a) the recipient of the income, i.e. the seller (currently, ED 70) and (b) the provider, i.e. the purchaser (currently, ED 72).
- Standard 2: '*Transactions with present (non-performance) obligations*' to include (a) the recipient of the resources, i.e. the transferee (currently, ED 71) and (b) the provider, i.e. the transferor (currently, ED 72).
- Standard 3: '*Transfers without obligations*', to include (a) the recipient of the resources, i.e. the transferee (currently, ED 71) and (b) the provider, i.e. the transferor (currently, ED 72).

The respective treatments by the two parties need not 'mirror' each other, that is, the respective treatments could be totally different; but at least the standard would treat a transaction holistically – from both perspectives.

Besides having a critical stance on the fact that expenses are handled in a separate ED, we also see the need for more clarity and guidance about the linkages between the three EDs, even with regards to terminology, perhaps through the compilation of **a joint glossary**. A joint glossary may ensure transparency on the important definitions and terms not only across the three EDs but in general across all the standards issued by the IPSASB. For example, in the three EDs, the IPSASB refers to definitions used in other standards. It would be easier for users of standards having a joint glossary rather than referring to different files.

May we also point out that the style of writing and the type of language used decrease understandability. We appreciate the technicality of the subject, and also that standards are targeted for practitioners. However, even accountancy professionals and academics find the standards difficult to understand. Practitioners in public sector accounting would encounter a similar difficulty, detracting from the

attractiveness of IPSAS.

3. Need to evaluate the challenges of applying ED70, 71 and 72 in practice

Since the changes introduced by the three EDs are wide-spanning, we recommend that the IPSASB should monitor the issues that will emerge from the practical application of these standards. Since pilot studies are not feasible in a public sector context, this monitoring should be undertaken with public sector entities that will be actually applying ED70, 71 and 72. The monitoring could be in the form of a survey, for example, in 2-3 years' time, that would capture and document the effects and practical experiences of applying the three EDs. This exercise would reveal challenges associated with applying the standards in practice and would support the strengthening of the application guidelines. It may also assist in future revision of the standards.

ED70 Specific Matters for Comment

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?

Response:

We agree with the scope of the Exposure Draft and consider that it is clear. However, we do not think that the scope is exhaustive. In order to be in line with IFRS 15, ED 70 focuses on how the seller accounts for revenue (from transactions that should have economic/commercial substance AG26-28), when in fact the majority of these sellers (refer to par. 25) would be private sector entities that need to account for revenue according to IFRS 15 anyway¹. On the other hand, public sector entities would be the purchasers. Since accounting by purchasers is not covered by ED 70, as it stands, then there seems to be little application for it in practice. It would be more useful if accounting by the purchaser is subsumed into this standard. In addition, we would like to emphasise that public sector entities are generally speaking not in a seller's position.

We agree with the definition of binding arrangements at an overarching level; however, we recommend that further clarification is provided. We note that the AG on Step 1 'Identifying the Binding Arrangement' is not very clear – the wording of AG26-28 vs AG29-31 could be more distinctive. This concerns the issue of collectability. There is some elaboration in BC37-41 (on page 100).² Par 8e requires the entity to evaluate the ability of the purchaser to pay, and then account for the transaction using the reduced consideration – thus introducing subjectivity.

¹ Examples 12 -14 (page 117) showing the debt of public works working with the Department of Housing/Health at a profit is unrealistic.

² Unbalanced power of the two parties to an agreement could lead to the following Example: An entity A is to construct a building for another B for CU10m. A starts recognizing revenue and expenses. When the building is ready, it is forced to reduce the price or make it zero (considered as a price concession). In the final year, there is a loss. The only solution that ED70 provides is disclosure of the reasons.

Specific Matter for Comment 2

This Exposure Draft has been developed along with [draft] IPSAS[X] (ED71), *Revenue without Performance Obligations*, and [draft] IPSAS[X] (ED72), *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?

Response:

Agree. However, ED 70 should make explicit reference to ED 71 in terms of transfer revenue. Please consider our comments above regarding the need for a joint glossary for the three EDs.

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?

Response:

We agree with the application guidance (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?

Response:

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

We would appreciate clarification of the following. The binding arrangement asset is amortized and tested for impairment. Shouldn't these costs be separately disclosed on the face of the Statement of Financial Performance? Appendix B, pages 65-66, does not show separate disclosure.

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?

Response:

Yes, we agree with adding the disclosure requirement for transactions which an entity is compelled to enter into by legislation or other governmental policy decisions. We recommend that guidance is developed to support this disclosure requirement. More specifically, we suggest that guidance is developed on disclosures pertaining to the issue of collectability. It is probably more relevant with respect to public sector organisations that provide services to individuals who are likely not to pay (e.g. emergency health care services to uninsured patients). The ED's position on collectability implies that these services will not appear in the statements as revenues and offsetting bad-debt expenses. In the IPSASB's view, transparency is ensured by disclosures in the notes, thus guidance for such note disclosure would be beneficial.

Other comments:

1. Refer to Page 103/4 BC56-58 on Enforceability: ‘... both parties agree to both the enforceable rights and obligations ...’ however, both parties do not have the same level of power. In BC58, if an announcement does not create a binding agreement, how can IPSAS 19 apply? This needs clarification.

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Signed on behalf of the persons listed below:

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