

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

Comments and suggestions considering the IPSASB document for ED 72 'Transfer Expenses'

The IPSASB has requested comments and answers to specific questions regarding its Exposure Draft (ED) 72, *Transfer Expenses*. 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 72 contains proposals for transfer expenses, superseding the requirements of IPSAS 23 *Revenue from Non Exchange Transactions*.

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 ED72.

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.

ED72 Specific Matters for Comment

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?

Response:

The Standard is devoted to transfer expenses, which are defined as follows:

“A transfer is a transaction in which one institutional unit provides a good, service, or asset to another unit without receiving from the latter any good, service, or asset in return as a direct counterpart.”

This definition highlights two important elements: on the one hand, transfers may be made of goods, services or assets; on the other hand, these transactions are characterized as being without an equivalent compensation such as a commercial price.

As explained in the rest of the ED, different types of transfers may arise according to whether the transfer recipient has or does not have discretion over how and when to use the transfer received. In particular, three situations may occur:

- Transfer expenses with performance obligation.
- Transfer expenses without performance obligation but with binding arrangement.
- Transfer expenses without performance obligation and without binding arrangement.

While the definition of transfer is clear, its application is a bit confusing, especially with reference to *transfer expenses with performance obligation*. In fact, ED72 specifically states that it does not address *transfer expenses with performance obligations*, unless the goods/services are provided to a third party:

“A transfer provider may incur transfer expenses in accordance with a binding arrangement it has entered into with a transfer recipient, which requires the transfer recipient to provide goods or services to a third-party beneficiary.”

Following this definition, the standard also classifies as transfers those transactions that are commercial in nature and that require the accomplishment of a performance obligations by the resource recipient. This is clear, for instance, in Example 1 Case B, which illustrates the following situation:

“An international organization enters into a binding arrangement to purchase a vehicle from a motor dealer for CU30,000. The binding arrangement requires the dealer to transfer the vehicle, and provide the subsequent maintenance services, to a national government.”

While this transaction is seen as a transfer with performance obligation in the ED - the transfer provider is the international organization, the transfer recipient is the dealer, which is required to transfer goods and services to a third-party beneficiary (the national government) - in our opinion, two different transactions exist here:

- (a) a transaction with the dealer that cannot be treated as a transfer as it is a commercial exchange; *and*

- (b) a transaction with the national government that is a transfer of goods with no performance obligation.

Moreover, we think that the two transactions emerge as results of two different binding arrangements: one with the dealer and another with the national government.

We propose to limit the scope of the standard by clarifying that transfer expenses that entail a commercial buyer/seller relationship should be treated as direct exchange transactions (that are outside the scope of the standard, as stated in AG 5, page 44). This limitation would imply that transfer expenses with performance obligation occur only in situations similar to the one depicted in Example 4, case D of the ED, where the binding arrangement includes performance obligations for the transfer recipient, whereby the relationship between the transfer provider and the transfer recipient is non-commercial and without equivalent compensation such as a commercial price.

In case the scope of the ED is changed as we are suggesting, we encourage the IPSASB to be clearer about what should be viewed as a third party (and provide more extensive guidance and examples). For instance, it should make clear that the constituents/residents/citizens of the government that provides transfers cannot be viewed as a third party, because otherwise, the majority of transactions of a government would end up being considered as a transfer. In the absence of specific guidelines, for instance, the contracts signed for the provision of individual/collective services by either a for-profit or non-profit organization could be considered as transfers: when services are contracted-out, public sector entities transfer money to another entity, be it a for-profit or non-profit organization, and does not get anything in return since services are provided to citizens. Similarly, the standard should provide clear indications on more complex situations. For example, what happens if the transfer provider and recipient are different tiers of government (e.g. regional and local government), so that the residents of the transfer provider are by definition also residents of the transfer recipient?

Finally, as in the case of revenues, the overall structure of the ED ends up being unbalanced because the case of performance obligations comes first and is discussed extensively, but it is probably the least frequent: usually transfer expenses come without performance obligations. Hence, we suggest revising the structure of the standard. Alternatively, we suggest modifying the scope of the three EDs (please, see our introductory section and SMC1 of ED70).

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?

Response:

We have some concerns in this respect that are explained in response to SMC1.

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?

Response:

Yes, we agree. The Public Sector Performance Obligation Approach (PSPOA) only applies where the beneficiary is a third party (AG24, page 46). For the application of the PSPOA, monitoring is very important so that the accounting of the transactions mirror each other. However, monitoring may not always be easy or possible. So it is welcome that the ED72 proposes par. 13 (towards the end of the paragraph) and AG27 (page 47), with the solution that the transaction is then recorded as a transfer expense without a performance obligation. The probability of this causing consolidation issues is remote. On the one hand, monitoring would not be possible when the transfer recipient is not under the control of the transfer provider. On the other hand, in many cases the transfer beneficiary will not even be a public sector entity, which further reduces the concerns for consolidation.

However, we want to highlight that this proposal may be risky in that it gives large discretion to reporting entities. The impossibility to monitor should reflect objective difficulties and not the limited monitoring capacity of the entity. Otherwise, the risk is that each entity will opt for the recognition that is deemed more favourable.

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 transferring 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?

Response:

Yes, we agree. However, regarding point (a) it should be noted that the transfer provider should recognize an asset only when the transfer is made at the start of the binding arrangement (so that the transfer provider records an outflow of cash) or when the terms of the binding arrangement would result in the transfer provider having a present obligation to transfer resources to the transfer recipient prior to the transfer recipient having satisfied its performance obligations (so that the transfer provider recognizes a liability) (see BC 21). Conversely, when the transfer is made at the end of the binding arrangement, the transfer provider recognizes an expense and a binding arrangement liability as the transfer recipient accomplishes its performance obligation (see for instance example 36). We suggest that the main text of the standard is modified to clarify the different accounting treatments in the two cases.

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.

Response:

We think that the main practical difficulties are described in AG51-52. The solution in par. 13 that the transaction is then recorded as a transfer expense without a performance obligation appears sufficient. However, we think that other difficulties may arise when applying the standard. Hence our suggestion to closely monitor the standard's actual adoption and the related challenges.

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?

Response:

We agree. However, we have some doubts, largely stemming from a close reading of Example 34. The example refers to transfer expenses without performance obligations, made as a series of transfers. In particular, the example depicts the following case:

"A regional government (the transfer provider) enters into a binding arrangement with a museum on January 1, 20X1, whereby the regional government will provide CU100,000 per year for three years for the museum to purchase additional artefacts."

Two cases are presented:

Case A – in which the future payments depend on performance

"The binding agreement also requires the regional government to transfer CU100,000 to the museum on January 31, 20X2 and January 31, 20X3, provided that the museum has acquired the artefacts in the previous year."

Case B – in which the future payments are due in all circumstances

"The binding arrangement requires the regional government to transfer CU100,000 to the museum on January 31, 20X1. The binding agreement also requires the regional government to transfer CU100,000 to the museum on January 31, 20X2 and January 31, 20X3. The binding arrangement requires the regional government to make the future payments irrespective of whether the museum has acquired the intended artefacts or not."

With reference to this example, the following critical issues emerge:

- The situation depicted in the example rarely occurs since usually governments decide on a year-by-year basis the grants to be transferred.
- Focusing on year 20X1, we do not agree that the present obligation (CU 100,000 for case A and CU 300,000 for case B) should be recognized on January 31, 20X1 (that is when funds are due), but on January 1, 20X1, as the regional government has little or no realistic alternative to avoid the binding obligation and the related outflow of resources at that point, after entering into the binding arrangement.
- We think that a case C should be added whereby the whole sum (CU 300,000) is paid to the museum in 20X1 to fund the purchase of artefacts over three years. What should the regional government record in this case? Should it recognize an expense of the total amount of CU 300,000, similar to case B?

In general, we think that a clearer definition of “present obligation” may help to properly record transfers 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 recognizes revenue.

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

Response:

As stated in our response letter to the IPSASB's Consultation on Accounting for Revenue and Non-Exchange Expenses, our view is that recognition of revenues and expenses should reflect the essence of the transaction from the lens of each part that is involved. It is important that public sector entities' revenue is not anticipated and/or overstated. Moreover, we acknowledge that a "mirror approach" may facilitate consolidation, thus we suggest that the Board takes appropriate consideration of consolidation issues when revising guidance.

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?
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Response:

We partially agree with this proposal.

In our opinion, when resources to be transferred are subject to the appropriation being authorized, the authorization has a substantive role, except for particular circumstances or under specific legal frameworks. As already pointed out, in our opinion the legal form is generally indisputable, so the “substance over form” principle may be acceptable only in certain administrative regimes.

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?

Response:

We agree with the disclosure requirements included in the ED.

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Signed on behalf of the persons listed below:

Aggestam Pontopiddan	Caroline	Associate Professor of Accounting	Copenhagen Business School, Denmark
Anessi Pessina	Eugenio	Professor of Public Management	Università Cattolica del Sacro Cuore, Milan, Italy
Biondi	Yuri	Senior Tenured Research Fellow of the CNRS	IRISSO, University Paris Dauphine PSL, France
Bisogno	Marco	Associate Professor of Accounting	University of Salerno, Italy
Brusca	Isabel	Professor of Accounting and Finance	University of Zaragoza, Spain
Caperchione	Eugenio	Professor of Public Management	Department of Economics “Marco Biagi”, Modena and Reggio Emilia University, Italy
Caruana	Josette	Senior Lecturer, Department of Accountancy	University of Malta, Malta
Christiaens	Johan	Professor of Public & Non-profit Sector Accounting, CPA	Department of Accounting, Corporate Finance and Taxation, Ghent University, Belgium
Cohen	Sandra	Professor of Accounting	Department of Business Administration, Athens University of Economics and Business, Greece
Dabbicco	Giovanna	Researcher, Department of National Accounts	ISTAT, Italy
Haustein	Ellen	Lecturer and Scientific Researcher for Accounting, Management Control and Auditing	University of Rostock, Germany
Jorge	Susana	Tenured Professor with accreditation	Faculty of Economics, University of Coimbra, Portugal
Lorson	Peter	Professor of Accounting, Management Control and Auditing	University of Rostock, Germany
Manes Rossi	Francesca	Associate Professor of Accounting, CPA, co-chair of EGPA PSGXII	University of Napoli, Federico II, Italy
Reichard	Christoph	Professor Emeritus of Public Management	University of Potsdam, Germany
Sicilia	Mariafrancesca	Associate Professor of Public Sector Management and Accounting	University of Bergamo, Italy
Steccolini	Ileana	Professor of Accounting & Finance	Essex University, U.K.