



Treasury

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Mr John Stanford
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Dear Mr Stanford

Exposure Drafts – IPSASB ED’s 70-72

The Heads of Treasuries Accounting and Reporting Advisory Committee (HOTARAC) welcomes the opportunity to respond to the IPSASB Exposure Drafts (ED) 70-72. HOTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee comprises the senior accounting policy representatives from all Australian States, Territories and the Australian Government.

The attachment to this letter sets out HOTARAC’s response to the specific matters for comment. Broadly HOTARAC agrees with ED 70 Revenue with Performance Obligations. However, HOTARAC has concerns with both ED 71 Revenue without Performance Obligations, relating to the recognition of liabilities by transfer recipients for outstanding present obligations and with ED 72 Transfer Expenses, relating to the recognition of assets by the transfer provider for the transfer recipient’s outstanding performance obligations.

If you have any queries regarding HOTARAC’s comments, please contact Vincent Padgham from the Australian Commonwealth Department of Finance on (02) 6215 1927 or by email to vincent.padgham@finance.gov.au.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Stewart Walters', with a long horizontal flourish extending to the right.

Stewart Walters
CHAIR
Heads of Treasuries Accounting and Reporting Advisory Committee
30 October 2020

ENCLOSED:

HoTARAC Comments to the AASB IPSAS ED70-72

Exposure Drafts – IPSASB ED 70-72 Revenue with and without Performance Obligations and Transfer Expenses

ED 70 Revenue with Performance Obligations

Specific Matter for Comment 1: This Exposure Draft is based on IFRS 15 *Revenue from Contracts with Customers*. Because in some jurisdictions public sector entities may not have the power to enter into legal contracts, the IPSASB decided that the scope of this Exposure Draft would be based around binding arrangements. Binding arrangements have been defined as conferring both enforceable rights and obligations on both parties to the arrangement. Do you agree that the scope of this Exposure Draft is clear? If not, what changes to the scope of the Exposure Draft or the definition of binding arrangements would you make?

HOTARAC agrees subject to the comments below.

HOTARAC disagrees with paragraph AG24 of ED 70, which states that arrangements may not be enforceable in substance if the purchaser has not previously enforced corresponding arrangements where breaches have occurred. HOTARAC suggests that enforceability depends solely on the customer's capacity to enforce its rights, rather than a history of enforcement of similar agreements.

HOTARAC also notes that it may be unclear whether ED 70 applies to arrangements where funding recipients receive partial contributions for a specified initiative (eg. 50/50 cost sharing arrangements).

Specific Matter for Comment 2: This Exposure Draft has been developed along with [draft] IPSAS [X] (ED 71) *Revenue without Performance Obligations*, and [draft] IPSAS [X] (ED 72) *Transfer Expenses*, because there is an interaction between them. Although there is an interaction between the three Exposure Drafts, the IPSASB decided that even though ED 72 defines transfer expense, ED 70 did not need to define “transfer revenue” or “transfer revenue with performance obligations” to clarify the mirroring relationship between the exposure drafts. The rationale for this decision is set out in paragraphs BC20–BC22. Do you agree with the IPSASB's decision not to define “transfer revenue” or “transfer revenue with performance obligations”? If not, why not?

HOTARAC agrees. The scope of ED 70 encompasses both transfer and non transfer revenues, covering binding arrangements with performance obligations to either the purchaser or a third party beneficiary. Accordingly, a definition of transfer revenues is unnecessary.

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?

HOTARAC agrees. HOTARAC notes though that it may often not be clear whether performance obligations exist and whether ED 70 or ED 71 should apply (such as whether performance obligations are sufficiently specific and measurable). Further guidance would be helpful in this area.

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?

HOTARAC notes that disclosures are only required where material (ED 70(112)). Nevertheless, we still believe the disclosures specified may be too detailed and onerous, particularly at the level of individual agencies and where intra agency transactions are common.

HOTARAC recommends the IPSASB consider whether some ED 70 disclosure requirements should only apply in consolidated government financial statements. For example, the requirements for the reconciliation of movements in the transfer recipient's receivables, binding arrangement assets and liabilities and the disaggregation of revenues from binding arrangements into separate categories require detailed disclosures would not seem to be justified for all public sector reporting entities.

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?

HOTARAC agrees.

ED 71 Revenue without Performance Obligations

Specific Matter for Comment 1: (Paragraphs 14-21) The ED proposes that a present obligation is a binding obligation (legally or by equivalent means), which an entity has little or no realistic alternative to avoid and which results in an outflow of resources. The IPSASB decided that to help ascertain whether a transfer recipient has a present obligation, consideration is given to whether the transfer recipient has an obligation to perform a specified activity or incur eligible expenditure. Do you agree with the IPSASB's proposals that for the purposes of this [draft] Standard, *Revenue without Performance Obligations*, a specified activity and eligible expenditure give rise to present obligations? Are there other examples of present obligations that would be useful to include in the [draft] Standard?

HOTARAC does not agree that a transfer recipient has a liability where it does not have outstanding performance obligations, but rather is only required to perform a specified

activity or incur eligible expenditure. HOTARAC views the ED 71 definition of present obligation as too broad, leading to recognition of liabilities that are avoidable obligations.

HOTARAC does not believe that requirements to perform specified activities or incur eligible expenditure represent present obligations for which settlement is expected to result in outflows of resources. Rather, the assets received by the transfer recipient are restricted assets that are still able to be used to achieve the transfer recipient's objectives. Any liability can be avoided by the transfer recipient by using the assets received in accordance with the conditions specified by the transfer provider.

ED 71 introduces a second threshold for deferring recognition of income, that is a lower threshold than contained in ED 70. HOTARAC believes this makes the overall framework for income recognition overly complex and it will be difficult for users to understand. In particular, some arrangements without performance obligations will be recognised on receipt of cash, while others will be recognised over time. Given the volume of inter government transfers, implementation of ED 71 would likely be costly.

More guidance is required to explain when a 'specified activity' and/or 'eligible expenditure' create a present obligation.

Specific Matter for Comment 2: (Paragraph 31) The flowchart that follows paragraph 31 of this [draft] Standard illustrates the process a transfer recipient undertakes to determine whether revenue arises and, if so, the relevant paragraphs to apply for such revenue recognition. Do you agree that the flowchart clearly illustrates the process? If not, what clarification is necessary?

HOTARAC agrees. However, HOTARAC would also recommend more guidance on when receivables should be recognised. Distinguishing between non-binding arrangements and arrangements with present obligations involving specified activities is also likely to often be difficult in practice (eg. research and development projects) and further guidance would be useful.

Specific Matter for Comment 3: (Paragraph 57-58) The IPSASB decided that a transfer recipient recognizes revenue without performance obligations but with present obligations when (or as) the transfer recipient satisfies the present obligation. Do you agree that sufficient guidance exists in this [draft] Standard to determine when a present obligation is satisfied and when revenue should be recognized? For example, point in time or over time. If not, what further guidance is necessary to enhance clarity of the principle?

Overall, ED 71 would result in an additional burden on public sector entities to gather information on their fulfilment of present obligations to recognise revenue. Determining the fulfilment of present obligations will not always be clear, especially when transfers are provided to carry out specified ongoing activities.

The application guidance and illustrative examples in ED 71 appear limited on this issue and there is no guidance on how 'specified activity' and 'eligible expenditure' impact the pattern of revenue recognition. For example, grant programs may provide full or partial reimbursement only once expenditure claims are submitted and audited. This is a common inter-government arrangement for which further examples would be helpful. In contrast,

there is clear criteria in IFRS 15 and related publications on whether the satisfaction of performance obligations should be recognised over time or at a point in time.

Specific Matter for Comment 4: (Paragraphs 80-81) The IPSASB decided that the objective when allocating the transaction price is for a transfer recipient to allocate the transaction price to each present obligation in the arrangement so that it depicts the amount to which the transfer recipient expects to be entitled in satisfying the present obligation. The amount of revenue recognized is a proportionate amount of the resource inflow recognized as an asset, based on the estimated percentage of the total enforceable obligations satisfied. Do you agree sufficient guidance exists in this [draft] Standard to identify and determine how to allocate the transaction price between different present obligations? If not, what further guidance is necessary to enhance clarity of the principle?

HOTARAC views the application guidance and illustrative examples as limited on this issue.

Specific Matter for Comment 5: (Paragraphs 84-85) Do you agree with the IPSASB's proposals that receivables within the scope of this [draft] Standard should be subsequently measured in accordance with the requirements of IPSAS 41 *Financial Instruments*? If not, how do you propose receivables be accounted for?

HOTARAC disagrees. HOTARAC views this as creating practical difficulties. For example, applying fair value measurement to, or estimating expected credit losses for, taxation revenue would require sophisticated actuarial modelling of economic activities. Other non-contractual receivables may also require anticipation of economic activity, which would be onerous and only provide marginal benefit to users of financial reports.

Specific Matter for Comment 6: (Paragraphs 126-154) The disclosure requirements proposed by the IPSASB for revenue transactions without performance obligations are intended to provide users with information useful for decision making, and to demonstrate the accountability of the transfer recipient for the resources entrusted to it. Do you agree the disclosure requirements in this [draft] Standard provide users with sufficient, reliable and relevant information about revenue transactions without performance obligations? In particular,

- (i) what disclosures are relevant;
- (ii) what disclosures are not relevant; and
- (iii) what other disclosures, if any, should be required?

HOTARAC notes that the disclosures are only required where material (ED 71(130)). Nevertheless, the disclosure requirements may still be detailed and onerous, particularly at the level of individual agencies.

HOTARAC recommends these requirements be streamlined to keep financial statements as concise as possible, such as through reducing disclosures for entities below the consolidated government level. For example, the requirement for reconciliation of movements in the transfer recipient's receivables, binding arrangement assets and liabilities and the disaggregation of revenues with present obligations into separate categories require detailed disclosures which do not seem justified for all public sector reporting entities.

Specific Matter for Comment 7: (Paragraphs N/A) Although much of the material in this [draft] Standard has been taken from IPSAS 23 *Revenue from Non Exchange Transactions (Taxes and Transfers)*, the IPSASB decided that the ED should establish broad principles for the recognition of revenue from transactions without performance obligations, and provide guidance on the application of those principles to the major sources of revenue for governments and other public sector entities. The way in which these broad principles and guidance have been set out in the ED are consistent with that of [draft] IPSAS [X] (ED 72), *Transfer Expenses*. Do you agree with the approach taken in the ED and that the structure and broad principles and guidance are logically set out? If not, what improvements can be made?

Agree. HOTARAC notes that there is asymmetrical accounting treatment between ED 71 and ED 72 in relation to binding arrangements without performance obligations, where the transfer recipient has outstanding present obligations and the transfer provider's payment is not refundable unless the transfer recipient breaches required conditions. In this situation the transfer recipient may recognise a liability rather than revenue until present obligations are fulfilled, whereas the transfer provider would recognise an expense immediately.

ED 72 Transfer Expenses

Question 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?

The boundaries between the scope of ED 72 and related IPSAS standards, such as IPSAS 42 *Social Benefits*, is not clear. Guidance or illustrative examples on this issue may be helpful. HOTARAC also notes that the definition of transfer expenses in ED 72 does not address the extent to which the transfer provider's overhead expenses should be attributed.

Question 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?

HOTARAC views the distinction between transfer expenses with and without performance obligations as sometimes being difficult to apply in practice. It would also require detailed assessments of a large number of arrangements, including arrangements between subsidiaries of governments. It is not clear the benefits of this requirement match the costs of compliance. Further guidance or illustrative examples on this issue would be helpful.

Question 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?

Agree, noting the disclosure requirement in paragraph 151. ED 72 could make clear that similar binding arrangements with performance obligations may be accounted for by transfer

providers differently, depending on whether they choose to monitor the transfer recipient's satisfaction of performance obligations. More guidance would be helpful where the transfer provider's periodic monitoring of the transfer recipient's satisfaction of performance obligations does not align with their financial reporting dates.

Question 4. This [draft] Standard proposes the following recognition and measurement requirements for transfer expenses with performance obligations:

- (a) A transfer provider should initially recognize an asset for the right to have a transfer recipient transfer goods and services to third-party beneficiaries; and
- (b) A transfer provider should subsequently recognize and measure the expense as the transfer recipient transfers goods and services to third-party beneficiaries, using the public sector performance obligation approach.

The rationale for this decision is set out in paragraphs BC16–BC34. Do you agree with the recognition and measurement requirements for transfer expenses with performance obligations? If not, how would you recognize and measure transfer expenses with performance obligations?

HOTARAC believes it is questionable whether assets recognised by transfer providers, for grants where the transfer recipient's provision of goods and services to third parties is still outstanding, meets the definition criteria of assets. Applying the performance obligation framework of ED 72 would also be difficult in practice and may not provide significant benefits to users of the financial reports.

The chronology of requirements ED 72 is confusing. Step 5 is addressed in paragraphs 33-46, whereas Steps 3 and 4 are addressed subsequently in paragraphs 47-71 and 72-85 respectively. HOTARAC recommends structuring the requirements of ED72 in the order of steps from 1 to 5.

The requirement for the transfer provider to initially recognise an asset is implied, due to the subsequent requirement to recognise the expense when (or as) performance obligations are satisfied. However, ED 72 does not specifically include this requirement in black letter.

Question 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.

Complex monitoring, accounting and auditing procedures may be required if ED 72 was implemented. Transfer providers and auditors will have to rely heavily on transfer recipients providing accurate and timely information when monitoring satisfaction of performance obligations.

The performance of recipients is currently not monitored in many government grant projects in Australia. ED 72 may be particularly onerous for grant programmes with many small, low risk grants, such as where strong grantee selection processes have already been applied.

Grantors may not have information at financial year end to accrue for grant expenses because grant payments are often made on milestone basis, which may not align with financial

reporting dates. Grantors often require funding recipients to report on achievement of milestones, but rarely ask for cut-off information as at financial year end.

The distinction between binding arrangements with or without performance obligations, the identification of distinct performance obligations and measuring their completion may require considerable judgement in practice. HOTARAC recommends expanding the guidance and suggests the IPSASB consider the Australia guidance for not for profit entities in AASB 15 *Revenue from Contracts with Customers* (the Australian equivalent to IFRS 15) and related publications on these issues.

Where central government provides grants to provincial or state governments who in turn pass these on to other recipients, a lack of accounting symmetry may also occur to the extent that the performance or present obligations in the central government agreement differ to those in the agreements between the state/provincial government and recipient.

Question 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?

HOTARAC agrees.

Question 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?

HOTARAC notes that symmetry may not occur in practice for a number of reasons, such as different judgements by transferor and transferee about the existence and satisfaction of performance obligations or different financial reporting dates. HOTARAC disagrees with the proposal in ED 71 that transfer recipients should recognise a liability for outstanding present obligations as currently defined.

Question 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?

HOTARAC Agrees. Recognition of a liability should reflect individual circumstances as to whether the transfer provider has a present obligation prior to the appropriation being provided. HOTARAC further recommends guidance on accounting implications where assessments have changed on whether appropriations will be authorised.

Question 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?

HOTARAC notes that disclosures are only required where material (paragraph 130). Nevertheless, the disclosure requirements may still be too detailed and onerous, particularly at the level of individual agencies.

HOTARAC recommends these requirements be streamlined to keep financial statements as concise as possible, such as through reducing disclosure requirements for entities below the consolidated government level. For example, the requirements for reconciliation of movements in the transfer provider's binding arrangement assets and liabilities and the disaggregation of expenses with and without performance obligations into separate categories require detailed disclosures which do not seem justified for all public sector reporting entities.