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International Public Sector Accounting Standards Board Consultation Paper: *Accounting for Revenue and Non-Exchange Expenses*

This letter provides the U.S. Government Accountability Office's (GAO) comments on the International Public Sector Accounting Standards Board's (IPSASB) Consultation Paper (Consultation Paper) entitled *Accounting for Revenue and Non-Exchange Expenses*. We welcome the opportunity to comment on the Consultation Paper and support the board's efforts to reevaluate requirements and guidance for revenue transactions and non-exchange expense transactions. Our responses to the questions in the Consultation Paper follow.

1. Preliminary View 1 (following paragraph 3.8)
The IPSASB considers that it is appropriate to replace International Public Sector Accounting Standard (IPSAS) 9, *Revenue from Exchange Transactions* and IPSAS 11*, Construction Contracts* with an IPSAS primarily based on International Financial Reporting Standard (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 that establishes performance obligations.

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

We are in agreement with Preliminary View 1. The IPSASB has an objective of convergence with The International Accounting Standards Board (IASB) standards, where appropriate.[1] Towards that end, for Category C revenue transactions in the public sector, which are similar in nature and substance to for-profit revenue transactions, the IPSASB considers that the standards-level requirements and guidance of the IPSASB and IASB should be converged and provide the same outcomes. We agree that the extent of the modifications to IPSAS 9 and 11 as described in Preliminary View 1 will be generally limited to changes of terminology rather than substance.

[1] IASB is an independent, private-sector body that develops and approves International Financial Reporting Standards.

2. Preliminary View 2 (following paragraph 3.9)
Because Category A revenue transactions do not contain any performance obligations or stipulations, the IPSASB considers that these transactions will need to be addressed in an updated IPSAS 23, *Revenue From Non-Exchange Transactions (Taxes And Transfers)*.

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

The Consultation Paper defines Category A revenue transactions as revenue transactions with no performance obligations or stipulations. Such transactions include general taxation receipts and inter-governmental transfers, such as non-specific and non-earmarked grants. IPSAS 23 prescribes requirements for the financial reporting of revenue arising from non-exchange transactions, other than non-exchange transactions that give rise to an entity combination, and deals with issues that need to be considered in recognizing and measuring revenue from non-exchange transactions. As such, we agree that Category A revenue transactions should be addressed in an updated IPSAS 23, as indicated in Preliminary View 2.

3. Specific Matter for Comment 1 (following paragraph 3.10)
Please provide details of the issues that you have encountered in applying IPSAS 23, together with an indication of the additional guidance you believe is needed in an updated IPSAS 23 for:

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

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

We provide no comments on Specific Matter for Comment 1.

4. Preliminary View 3 (following paragraph 4.64)
The IPSASB considers that Category B transactions, which are transactions with performance obligations or stipulations that do not meet all the requirements of IFRS 15, should be accounted for using the *Public Sector Performance Obligation Approach (PSPOA)*.

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

The development of the *PSPOA* for the public sector would mean that the current distinction between exchange and non-exchange transactions as the primary determination of accounting treatment for many transactions would be replaced with a distinction between transactions with performance obligations and those without performance obligations. As noted in our response to Specific Matter for Comment 3, we support the application of an updated IPSAS 23 approach to Category B transactions and not the application of the PSPOA to such transactions. We believe that non-exchange transactions are unique to the public sector and should be treated consistently (i.e., Category A and B transactions as well as transactions related to social benefits). We also question if determining whether the transaction has a performance obligation under the PSPOA would necessarily be more feasible and understandable than developing and applying a clarified distinction between exchange and non-exchange transactions to determine the appropriate accounting treatment.

5. Specific Matter for Comment 2 (following paragraph 4.64)
The IPSASB has proposed broadening the requirements in the IFRS 15 five-step approach to facilitate applying a performance obligation approach to Category B transactions for the public sector. These five steps are as follows:

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

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

While we do not have specific comments on the content of the IFRS 15 five-step approach, we do not support the application of the PSPOA to Category B transactions, as discussed in our response to Specific Matter for Comment 3.

6. Specific Matter for Comment 3 (following paragraph 4.64)
If the IPSASB were to implement Approach 1 and update IPSAS 23 for Category B transactions, which option do you favor for modifying IPSAS 23 for transactions with time requirements (but no other stipulations):

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

Please explain your reasons.

It is our view that an updated IPSAS 23 approach should be applied to Category B transactions. We favor updating IPSAS 23 through a combination of Option (b)—Require enhanced display/disclosure—and an option other than those listed above in Specific Matter for Comment 3. Under this other option, IPSAS 23 would be updated in a manner that is consistent with the Board's proposed broadening of the interpretation of the "enforceability" of performance in the PSPOA. As discussed in paragraph 4.32, the Board is proposing that the "enforceability" of performance in the PSPOA be expanded beyond the obligation of the resource recipient to return resources directly to the resource provider (as in the current IPSAS 23) to include all situations where the transferor of resources is able to take remedies in the event the resource recipient does not fulfill its performance obligation. The Board considers that interpreting "enforceability" in such a manner reflects the public sector context of binding arrangements, and that "enforceability" can be reflected by a range of non-contractual mechanisms, such as legislation, cabinet and ministerial decisions, and reductions of future funding for the same program.

It is our view that the definition of conditions in IPSAS 23, similarly, be expanded beyond an obligation of the resource recipient to return resources directly to the resource provider (as in the current IPSAS 23) to include all situations where the transferor of resources is able to take remedies in the event the resource recipient does not fulfill its performance obligation. Revising

IPSAS 23 in this manner may address some of the concerns associated with applying IPSAS 23.

7. Specific Matter for Comment 4 (following paragraph 4.64)
Do you consider that the option that you have identified in Specific Matter for Comment 3 should be used in combination with Approach 1 Option (a) – Provide additional guidance on making the exchange/non-exchange distinction?

(a) Yes
(b) No

Please explain your reasons.

Yes. We agree that the additional guidance should be developed for making the distinction between exchange and non-exchange transactions. Areas to address in such guidance might also include more clearly defining what “directly giving” and “approximately equal value” mean. As noted in our response to Preliminary View 3, non-exchange transactions are unique to public sector entities and should be treated consistently. Further, additional guidance should be developed for the “enforceability” concept (discussed in Specific Matter for Comment 3.)

8. Preliminary View 4 (following paragraph 5.5)
The IPSASB considers that accounting for capital grants should be explicitly addressed within IPSAS.

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

We agree that accounting for capital grants should be explicitly addressed within IPSAS.

9. Specific Matter for Comment 5 (following paragraph 5.5)

(a) Has the IPSASB identified the main issues with capital grants?
If you think that there are other issues with capital grants, please identify them.
(b) Do you have any proposals for accounting for capital grants that the IPSASB should consider?

Please explain your issues and proposals.

We believe that the Board has identified the main issues with capital grants. One other issue the Board may consider is a situation where a grant is made for the entire capital project, but the recipient is limited in the funds it may draw to those necessary to cover costs incurred by the recipient.

10. Specific Matter for Comment 6 (following paragraph 5.9)
Do you consider that the IPSASB should:

(a) Retain the existing requirements for services in- kind, which permit, but do not require recognition of services in-kind; or
(b) Modify requirements to require services in-kind that meet the definition of an asset to be recognised in the financial statements provided that they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information; or
(c) An alternative approach.

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

We believe that the IPSASB should modify requirements to require in-kind services that meet the definition of an asset to be recognized in the financial statements if they can be measured reliably and the services would have been purchased if they had not been donated. This would limit the implementation burden, while ultimately recognizing the cost of those services that would otherwise have been purchased by the entity.

11. Preliminary View 5 (following paragraph 6.37)
The IPSASB is of the view that non-exchange transactions related to universally accessible services and collective services impose no performance obligations on the resource recipient. These non-exchange transactions should therefore be accounted for under *The Extended Obligating Event Approach*.

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

We agree that non-exchange transactions related to universally accessible services and collective services should be accounted for under *The Extended Obligating Event Approach*.

12. Preliminary View 6 (following paragraph 6.39)
The IPSASB is of the view that, because there is no obligating event related to non-exchange transactions for universally accessible services and collective services, resources applied for these types of non-exchange transactions should be expensed as services are delivered.

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

We disagree with Preliminary View 6. We believe that there are obligating events for non-exchange transactions related to universally accessible services and collective services. Specifically, under *The Extended Obligating Event Approach*, we believe that it would be more appropriate to take a position that, given the nature of universally accessible services and collective services, an obligating event occurs when such services are provided to beneficiaries; however, present obligations may arise and liabilities may need to be recognized earlier for underlying transactions under other standards.[2] For example, the entity may incur liabilities and expenses related to exchange transactions prior to providing universally accessible services

[2] *The Extended Obligation Event Approach* states that the determining factor as to whether a resource provider has a liability and a corresponding expense or asset is whether there is an obligating event for the non-exchange transaction.

and collective services. Specifically, prior to the entity providing such services, it may purchase medical supplies to provide health care, purchase text books before the school term commences, or pay salaries and other costs for administrative activities. Further, the entity may incur liabilities when universally accessible services and collective services are provided to beneficiaries, but are paid for in a subsequent period.

In addition, in our view, it is critical that the accounting treatment for universally accessible services and collective services are consistent with the concepts proposed in the IPSASB *Social Benefits Exposure Draft* (Exposure Draft) issued in October 2017. For example, if there are two entities, one which provides universally accessible health care and one which provides health care benefits under the Exposure Draft, the accounting treatment should be consistent. For the entity with universally accessible health care, a liability would be incurred and an expense would be recognized when services are provided to eligible beneficiaries. However, for underlying transactions, a liability and an expense may be recognized earlier based on other standards, as noted above. For the entity which provides health care benefits under the Exposure Draft, a liability and an expense would be recognized when the beneficiary meets all of the eligibility criteria for the next benefit which generally occurs when the service is provided—such as when an eligible doctor provides an eligible health care service to an eligible beneficiary. Similar to universally accessible and collective services, liabilities and expenses may be recognized earlier for underlying transactions. In both situations, future obligations would be an aspect of the ongoing activities of the entities.

As the Board continues its efforts to develop possible improvements in the accounting for revenue and potential requirements and guidance for accounting for non-exchange expenses, we believe that it is essential for the Board to ensure consistency in the accounting treatment for universally accessible services and collective services as it works towards developing an accounting standard on Social Benefits.

13. Preliminary View 7 (following paragraph 6.42)
The IPSASB is of the view that where grants, contributions and other transfers contain either performance obligations or stipulations they should be accounted for using the Public Sector Performance Obligation Approach (PSPOA) which is the counterpart to the IPSASB's preferred approach for revenue.

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

We do not agree that where grants, contributions and other transfers contain either performance obligations or stipulations they should be accounted for using the PSPOA. Rather, we believe they should be accounted for under the *Extended Obligating Event Approach*, consistent with the reasoning stated in our response to Preliminary View 3.

14. Preliminary view 8 (following paragraph 7.18)
The Board considers that at initial recognition, non-contractual receivables should be measured at face value (legislated amount) of the transaction(s) with any amount expected to be uncollectible identified as an impairment.

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

We agree 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.

15. Preliminary View 9 (following paragraph 7.34)
The IPSASB considers that subsequent measurement of non-contractual receivables should use the fair value approach.

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

We agree that subsequent measurement of non-contractual receivables should use the fair value approach.

16. Specific Matter for Comment 7 (following paragraph 7.46)
For subsequent measurement of non-contractual payables, do you support:

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

Please explain your reasons.

We believe that subsequent measurement of non-contractual payables should be based on the Cost of Fulfillment Approach. Such an approach is consistent with the IPSASB Conceptual Framework, relatively straightforward to apply, and produces understandable information.

We appreciate the opportunity to provide comments on the Consultation Paper. Please contact Robert Dacey, Chief Accountant at (202) 512-7439 or daceyr@gao.gov if you have questions on GAO's perspectives.

Sincerely,

Gary T. Engel

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Enclosure