ICAEW REPRESENTATION 09/18

Accounting for Revenue and Non-Exchange Expenses

ICAEW welcomes the opportunity to comment on the *Accounting for Revenue and Non-Exchange Expenses* consultation paper published by the International Public Sector Accounting Standards Board (IPSASB) in August 2017, a copy of which is available from this link.

This response of 15 January 2018 has been prepared on behalf of ICAEW by its Financial Reporting Faculty. Recognised internationally as a leading authority on financial reporting, the Faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. Comments on public sector financial reporting are prepared with the assistance of the Faculty's Public Sector Financial Reporting Development Committee. The Faculty provides an extensive range of services to its members including providing practical assistance with common financial reporting problems.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA UK

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City
icaew.com

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 147,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

For more information, please contact representations@icaew.com

icaew.com

MAJOR POINTS

Support for the consultation paper

1. We welcome the opportunity to contribute to this consultation on *Accounting for Revenue and Non-Exchange Expenses* in the public sector. We support IPSASB's broader strategy of focusing on public sector specific accounting issues since that is where there is a sizable gap in current accounting literature. It is in the public interest for more governments to adopt high quality internationally recognised accounting standards and the attractiveness of adopting IPSASs will increase with a wider coverage of relevant accounting issues.

2. This Consultation Paper (CP) proposes to broaden the IFRS 15 five step revenue recognition model to make it more suitable for the public sector. Whilst we do not disagree with the main proposals, care should be taken not to diverge from IFRS 15 unnecessarily. Close alignment between IPSASs and IFRSs will make adoption of IPSASs easier for governments as they would then have access to the IFRS talent pool. Every divergence diminishes that advantage.

Opportunity to professionalise

3. Adopting a Public Sector Performance Obligating Approach which is closely aligned to IFRS 15 could introduce a more professional approach to recognition of transactions. In the UK, most government entities are now required to clearly spell out their objectives and how these will be achieved, using financial reporting as a way to measure success. Adopting IFRS 15 would help in this drive to put more emphasis on results and performance.

4. Processes and systems may need updating to enable the identification of 'binding' arrangements and performance obligations and to allow the allocation of consideration to each performance obligation. Introducing a methodology that focuses on performance obligations would lead to better accountability and, ultimately, transparency if governments were to fully adopt this approach.

Principles of the conceptual framework

5. In Chapter 4, the CP proposes an update to IPSAS 23 to change the way transactions are recorded if time requirements are present. It appears to us that IPSASB are trying very hard to create liabilities when there are none. If a grant does not contain any conditions that require an entity to potentially return resources, then no liability exists, even if a time stipulation has been imposed.

6. We appreciate that entities would rather match grant income with intended expenditure but if monies received have no conditions attached, then anything but recognising them in full in the income statement would not be a faithful representation of the transaction.

UK government's IFRS 15 implementation

7. We would like to highlight some discussion points, which may be of interest, that took place in the UK when contemplating the adoption of IFRS 15 in the public sector (which has been adopted in full without any adaptations, although tax, duties, fines and penalties are out of scope):

- For fees, charges and levies, the "contract" was considered to be the legislation or regulations providing the ability for the entity to impose a charge on the customer and the requirement for the customer undertaking the relevant activities to be liable to pay the charge. The legislation would also provide the enforceability of the obligations on both parties.

- Performance obligations and separate transactions prices for fees, charges and levies were identifiable.
- Some highlighted the lack of enforceability for contracts between government bodies and whether this posed an issue where IFRS 15 states contracts need to be legally enforceable. This was not seen as an issue since it is expected that government bodies treat agreements between themselves as if it were akin to an enforceable contract.
- Applying the portfolio approach may be more cost effective than applying the standard to individual customers, especially for those entities which impose charges on a significant number of customers. Entities will need to ensure they evaluate which characteristics constitute a portfolio and develop the controls and processes needed to account for that portfolio.

RESPONSES TO CONSULTATION PAPER REQUEST FOR COMMENTS

Question 1

Preliminary View 1

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.

8. Yes, we agree with PV 1. Transactions on commercial terms, thus containing all elements required by IFRS 15, should be accounted for using that standard.

Question 2

Preliminary View 2

Because Category A 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.

9. We agree with PV 2 in relation to taxation, but some transfers may be accounted for using a modified performance obligation approach. Ideally, we would like to see a solution where an updated IPSAS 23 is predominately for tax, but fees, levies and charges are dealt with under a Public Sector Performance Obligation Approach (PSPOA), based on IFRS 15. See below for more detail.

10. The first step of the five-step recognition model in IFRS 15 is 'identify a contract with a customer'; the CP rightly proposes (paragraphs 4.31 – 4.35) a widening of this step by changing it to 'identify a binding arrangement'. We believe that a binding arrangement could exist in relation to fees, levies and charges. The UK government, in discussing the adoption of IFRS 15, concluded that the 'contract' in these circumstances would be the legislation or regulations enabling a government entity to impose a charge on a customer and the customer being liable to pay the charge. The legislation would provide the enforceability of the obligations on both parties. Therefore legislation and regulations could underpin the binding arrangement, enabling fees, levies and charges to be accounted for using the PSPOA.

Question 3

Specific Matter for Comment 1

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 other 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.

11. We do not have any additional recommendations to make for further guidance regarding IPSAS 23. We would only note that care is required in adding too much detailed guidance into what should remain a principles-based standard.

Question 4

Preliminary View 3

The IPSASB considers that Category B transactions should be accounted for using the Public Sector Performance Obligating Approach.

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

12. We agree with PV 3.

13. As the CP states, there are advantages and disadvantages to using either the exchange/non-exchange method or the PSPOA, but on balance we favour the latter. We believe that the PSPOA will have two key benefits for the public sector:

a. access to wider talent pool as standards remain aligned with IFRS;
b. a more commercial backdrop to accounting for revenue should enable stakeholders to hold an entity to account more easily as performance measures become more transparent.

Question 5

Specific Matter for Comment 2

The IPSASB has proposed to broaden 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 obligations (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 – Recognise 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.

14. We support the application of a performance obligation approach for Category B transactions. Not all public sector transactions will have the characteristics necessary to adopt the IFRS 15 model as it stands, therefore the current proposals to broaden the model seem sensible.

15. We do not recommend that IPSASB broaden the five-step model beyond what is already proposed in the CP at this stage but considers a post implementation review to gather the facts about how this standard is performing, from a preparer and also from a user perspective.

16. The CP is right to highlight that revenue should be recognised when an entity fulfils its performance obligations by delivering services in binding arrangements as well as when transferring a promised good or service to a customer. This scenario will need careful consideration for tripartite arrangements when services are not being delivered directly to the resource provider.

Question 6

Specific Matter for Comment 3

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.

17. For reasons outlined in our response to PV 3, we favour Approach 2 as opposed to Approach 1.

18. If IPSASB were to implement Approach 1, we would favour option (b) – require enhanced display/disclosure. We note that some preparers argue that IPSAS 23 is too restrictive in not allowing revenue to be recognised over time when funding is received for a specific purpose but there is no return obligation. However, if there is no liability (no obligation to return the funds) then monies received should not be deferred – it would not be faithfully representative, nor would it adhere to the conceptual framework principles.

19. UK local government reserves are frequently used to ring-fence certain transactions/balances to show users of the accounts that they have been earmarked for specific future use. Acknowledging IPSASB's reluctance to introduce accounting principles akin to 'Other Comprehensive Income', we believe that similar outcomes could be achieved via enhanced disclosures within net assets/equity rather than pursuing option (e).

20. We do not support option (c) or (d) as they are not conceptually sound propositions. These options create liabilities artificially which do not meet the definition of a liability in the conceptual framework.

Question 7

Specific Matter for Comment 4

Do you consider that the option that you 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.

21. As this CP states specifically, preparers find it challenging to make the distinction between exchange and non-exchange and we support additional guidance aimed at making that distinction easier. Although we prefer Approach 2, we support combining the option identified in SMC 3 with Approach 1, Option (a).

22. IPSASB should explore whether the difficulties originate due to the current definitions or whether more implementation guidance is required, as long as this does not undermine the principles-based approach of the standard. Ultimately, judgements in certain circumstances will be required and accounting standards will not be able to provide guidance for all eventualities.

Question 8

Preliminary View 4

The IPSASB consider 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.

23. Due to the materiality of capital grants and their extensive use across most government entities, we agree with PV 4.

Question 9

Specific Matter for Comment 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.

24. We believe that IPSASB have captured the main issues regarding capital grants. We agree with the CP that the pattern of revenue recognition is the main issue concerning the accounting for capital grants. The lack of guidance has led some preparers to adopt IAS 20 *Government Grants* methodologies to account for capital grants which are not in line with the conceptual framework and result in non-comparable outputs.

25. IPSASB should not follow the methodologies of IAS 20 since capital grants are recognised either as deferred income or as a reduction in the carrying value of the asset which is not in line with the conceptual framework if no conditions are attached to the grant.

26. We recommend that grant income be accounted for in the same way as other revenue – if a grant is received without any conditions, recognise as revenue; if there are conditions, record a liability until these have been satisfied.

Question 10

Specific Matter for Comment 6

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 an alternative approach please identify that approach and explain it.

27. Some international organisations, such as aid agencies and the UN, may have material services in-kind, but from our experience of UK government financial reporting, central and local governments generally do not have large services in-kind transactions. Unless IPSASB can provide more evidence of its usage across government jurisdictions and a need for further guidance in this area, we recommend (a) above, to retain the existing requirements of IPSAS 23.

Question 11

Preliminary View 5

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? If not, please give your reasons.

28. Yes, we agree with PV 5.

Question 12

Preliminary View 6

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.

29. Yes, we agree with PV 6.

Question 13

Preliminary View 7

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 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.

30. Yes, we agree with PV 7.

Question 14

Preliminary View 8

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.

31. We agree that non-contractual receivables should initially be measured at the legislated amount – face value - with any amount expected to be uncollectible identified as an impairment. These receivables should be presented gross with any impairments identified separately.

Question 15

Preliminary View 9

The IPSASB considers that subsequent measurement of non-contractual receivables should use the fair value approach.

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

32. Our favoured methodology for subsequent measurement of non-contractual receivables is approach 2 – amortised cost. We agree with the CP (paragraph 7.32) that non-contractual receivables resemble loans and receivables and should have the same subsequent measurement in accordance with IPSAS 29.

Question 16

Specific Matter for Comment 7

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.

33. We favour the amortised cost approach. We agree with the CP (paragraph 7.43) that non-contractual and contractual payables are similar and should be accounted for similarly. In many cases non-contractual payables are underpinned by legislation which gives these transactions qualities similar to those based on a contract. We do not believe the hybrid approach to be appropriate as it could easily lead to overly-complicated accounting and disclosures which will not help users.