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Ian Carruthers
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International Public Sector Accounting Standards Board
277 Wellington Street West
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Dear Mr. Carruthers

Exposure Draft 72 *Transfer Expenses*

I am pleased to make this submission on Exposure Draft 72 *Transfer Expenses*.

I have over 30 years of experience in accounting advisory functions of large accounting and auditing firms across a wide range of clients, industries and issues in the for-profit, not-for-profit, private, and public sectors. My clients across the business and government environments have included listed companies, unlisted and private companies, charitable and not-for-profit organisations, commonwealth, state and local government departments and agencies in the public sector, and government owned corporations (government business enterprises).

My current position is at the Queensland Audit Office where we audit Queensland state government entities, universities and local governments.

I have followed the IASB's project on IFRS 15 for over 10 years, and have been involved in the implementation of Australia's equivalent to IFRS 15 (AASB 15) in the public sector.

I include my detailed responses below.

Yours sincerely,

David Hardidge
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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?

I broadly agree with the scope. However, as noted below, I do not agree with the accounting.

Under the definition of transfer expense, procurement transactions (where the value of what one entity receives from another entity must be of approximately equal value, in the form of cash, goods, non-monetary assets and/or services – i.e. exchange transactions) would be scoped out. Procurement payments involving prepayments for goods and services would not have a specific accounting standard.

I note that some transactions, or parts of transactions, may not be scoped in correctly. That is because the definition of transfer expenses refers to the entity not receiving directly **any** good, service, or other asset in return. Consequently, the non-exchange component of some transactions may not be included in the scope, as the recipient may receive some value, but not full exchange value.

g) Services in-kind

In my response to ED71, I included in Other Comments, a reference to how Queensland accounts for below market payments. I.e. if government departments would otherwise have purchased the good or service, the amount is recognised at fair value (if fair vale can be measured reliably). So, income is "grossed-up" to recognise the below-market value component, and the expense is "grossed-up" to fair value. We do not "gross-up" the expense side, i.e. in the transfer provider's financials.

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?

As I note in Specific Matter for Comment 4, I do not agree with the accounting for transfer expenses with performance obligations.

I believe that transfer expenses with performance obligations and transfer expenses without performance obligations should be accounted for consistently (i.e. expense as incurred). As I note in Specific Matter for Comment 1, the definition of transfer expenses should distinguish between procurement (exchange) transactions and other transactions.

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?

As I note in Specific Matter for Comment 4, I do not agree with the accounting for transfer expenses with performance obligations.

What does “monitoring” mean? Almost all grants are “monitored” to some extent, including those under the scope of ED71.

It seems to me that to make the proposals workable, you need to receive information from the recipient in accordance with ED70. I have concerns in relation to monitoring / acquittals and the complexity of “mirror” accounting of ED70.

Acquittals / Monitoring

A significant issue is receiving the information in a sufficiently timely manner. In Queensland, state government departments and agencies generally have a 2 month deadline for signed financial statements – shorter than listed companies. Acquittal deadlines, even if aligned to the financial year end, are usually after the deadline for the preparation of transfer providers’ financials.

Also, acquittals are not always provided at financial year end – they can be throughout the financial year – so the financial year end position is not available at financial year end. Acquittals may be, for example, 6 months after project starts, or as a particular milestone is achieved (30% complete, 50% complete etc).

Different balance dates between the transfer provider and the transfer recipient are likely to exacerbate the problem.

Complexity of “mirror” accounting of ED70

Acquittals / monitoring is unlikely to match IFRS 15 / ED70 performance obligations categorisation / assessment. Significant issues include:

- assessing whether there are any performance obligations vs present obligations or no obligations. For example - research grants (some think that research grants is providing a service with performance obligations).
- assessing whether performance obligations are satisfied at a point in time or over time (mirror of ED70 paragraph 34(a), 34(b), 34(c)).
- splitting the arrangement into performance obligations. Many arrangements with reimbursement of set-up costs would appear to have to combine set-up activities with another promise(s) to be a performance obligation – complicating calculations.
- the classification of performance obligations (ED70 / ED72) may be different to the key performance indicators or outputs identified in the arrangement (acknowledged by paragraph AG35).
- whether the criteria for recognition as an expense (satisfaction of performance obligations being transfer of control by transfer provider) match the terms of the agreement vs accounting standard satisfaction of control. Transfer of goods under accounting standard can be any of the following, right to payment, legal title, physical possession, third party has accepted significant risks and rewards, third party has accepted the asset – satisfaction under agreement may be one of those, or something else.

- how to assess whether “transfer recipient’s performance does not create an asset with an alternate use” – this information would be difficult to assess by the transfer provider
- whether the criteria for assessing right of return has been met. The transfer recipient has the relationship with the third-party beneficiaries and it is the transfer recipient who would have the information to assess the amount of variable returns – i.e. goods have been transferred to the third-party beneficiary (using whatever criteria) but with a right of return that may not meet the ED72 criteria for recognition as a sale.
- whether variable consideration assessment would mirror the transfer recipient. Applying the revenue constraint to the transfer recipient is likely to understate the revenue (understate the receivable if in arrears / overstate the payable if in advance) compared to fair value / expected value. It is not clear how ED72 operates for the expense constraint, but on a conservative basis (similar to that used for revenue recognition) it would be the reverse of ED70 accounting for the revenue constraint – i.e. wanting to understate the asset (recipient liability if in advance) and overstate the liability (recipient receivable if in arrears).

I also expect significant calculation complexities and difficulties with modifications (paragraph 23) and the variety of possible treatments depending on the circumstances of the modification.

I noted above that set-up activities would likely have to be combined as one performance obligation (using mirror accounting). This would represent part of the transfer provider’s binding arrangement asset – yet the set-up activities have already been performed.

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 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?

I do not agree that the transfer provider’s binding arrangement asset representing a prepayment of resources to third-party beneficiaries represents an asset under the conceptual framework. The resources (usually cash) are no longer under the control of the transfer provider.

As I noted above under Specific Matter for Comment 1, the definition of transfer expenses appears to distinguish between procurement transactions (exchange transactions and benefits back to funding provider) from grants / transfers. I think this distinction is important. - under ED72 the transfer provider is not getting any direct benefits. I do not think that having already transferred the resources to the transfer recipient to transfer to third parties represents an asset to the transfer provider. The money (resources) has gone.

Given the distinction, it appears that procurement transactions do not have the complexity of this standard – something that I think is a good thing, and worth raising as an issue as to whether we need the complexity for transfer expenses.

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.

Under Specific Matter for Comment 3, I identified the following complexity issues:

- Assessing whether there are any performance obligations vs present obligations or no obligations
- Determining performance obligations, particularly dealing with set-up activities
- Dealing with performance obligations that are different to the key performance indicators under the arrangement
- Modifications and the variety of possible treatments
- Acquittal reporting not aligned with performance obligations
- Timeliness of acquittal reporting not soon enough after year end
- Assessment of whether the performance obligation has been satisfied (e.g. transfer of control) may not be the same as the agreement.
- Assessment of alternate use (Transfer recipient's performance does not create an asset with an alternate use – criteria for recognition over time)
- Assessment of rights of return
- Assessment of variable consideration

My solution is as I have suggested in Specific Matter for Comment 1 and 4 – do not use mirror accounting of ED70.

I expand on the following complexity issues below:

- Transfer recipient's performance does not create an asset with an alternate use (paragraph 36(c), 37)
- Revenue recognition not matching provider and recipient
- Right of return (paragraph 52)
- Non-refundable Upfront Fees (and some Related Costs) Paragraphs AG67 and AG68
- Bill and Hold arrangements (from paragraph AG85)

Transfer recipient's performance does not create an asset with an alternate use (paragraph 36(c), 37)

Paragraphs AG43 – AG45 provide some guidance, which seems to mirror that in ED70. However, on a practical basis, it would be very difficult for a transfer provider to have this information.

Revenue recognition not matching provider and recipient

How will the transfer provider know when the goods are transferred? Will the transfer of goods under the terms of the agreement on satisfaction of obligations be different to the accounting standard satisfaction of control? Transferring control can involve significant judgement – under the accounting standard can be any of the following, right to payment, legal title, physical possession, third party has accepted significant risks and rewards, third party has accepted the asset. Also see my comments on right of return below.

There are other practical issues. For example, for research activities (see my response for ED70), the Australian Accounting Standards Board (AASB) views research activities as the transfer of goods, and having access to the research information, and not as a service.

Right of return (paragraph 52)

How will the transfer provider know whether the criteria for assessing right of return by the transfer recipient has been met? The transfer recipient has the relationship with the third-party beneficiaries and it is the transfer recipient who will have the information to assess the amount of variable returns – i.e. goods have been transferred to the third-party beneficiary (using whatever criteria) but with a right of return that may not meet the ED72 criteria for recognition as a sale.

Non-refundable Upfront Fees (and some Related Costs) Paragraphs AG67 and AG68

These requirements will essentially require a mismatch of funding acquittals and accounting. Requiring this treatment (expensing over the life of the arrangement / performance obligations) essentially will require that the transfer recipient to be following ED70. Set-up activities are usually funding through upfront funding.

Bill and Hold arrangements (from paragraph AG85)

How would a transfer provider know if the transfer recipient is entering into a bill-and-hold arrangement?

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?

For (a), as I understand the proposals, it is basically to follow existing requirements, which I agree with.

For (b) I believe that if the asset given up has been disposed of (control lost), then the disposal should be recognised as a disposal – i.e. at fair value, and then that fair value used as the consideration for the transfer. I do not believe that the historical cost of PPE given up is an appropriate measure of consideration fo those assets given up.

Social benefit bonds

In practice, I have come across issues with social benefit bonds. These are also referred to as "pay for success". Government pays on successful outcomes, based on defined criteria. The aim is to reduce long-term government spending, e.g. on homelessness, youth criminal reoffending. The measurement period will usually include periods after the end of the minimum payment period, due to the time lag in the private sector organisation's actions and outcomes.

The government may pay a minimum amount (e.g. a standing charge). The private sector providers will provide their own money (raised through the social benefit bonds) to fund the activities. The private sector providers then get paid based on success. Those success payments are used to offset costs, and the remainder is then repaid to the social benefit bond holders.

Issues include:

- Are these performance obligations? Recipients get paid for performance, but there may not be any minimum performance – though they get paid for success – e.g. above a benchmark. So, are the targets "sufficiently specific" to meet requirement for a performance obligation under ED70? I believe that these are performance obligations and that ED70 accounting is appropriate, rather than ED71 accounting.
- Should the minimum amount payable (i.e. the standing charge) for the entire agreement period be recognised as a liability (and expense) upfront?
- How do these arrangements differ to multi-year grants? In practice, there was a requirement for the recipient to do a good job, act in good faith etc., so the amount payable was not a financial liability – i.e. obligation to pay cash that is just dependent on the passage of time.
- The ability for the grantor to direct how the proceeds are applied on a day-to-day basis may be less than traditional grants – what are the implications?
- When should the success payments (dependent on outcomes) be recognised? Some sort of accrual over time, or wait until outcomes are actually measured? There are often time lags. One time lag is the collection of data and statistics to measure performance. Another lag is that "success" may be measured after a certain period – e.g. success for youth criminal reoffending may be that the youth has not reoffended for 18 months after the support period. As these are for purchased services, I believe they should be accounted for under ED70 as the performance is satisfied.
- How should "reliable" measurement be assessed?
- How should budget estimates and forecasts be used?

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?

Paragraph 91 should make a specific reference to the application guidance in AG91 – AG102.

It is not clear what accounting paragraphs 90 and 91 are intended to result in. In particular, for:

- Payments for binding arrangements without performance obligations that meet the criteria for present obligations for ED71 (specific activities and eligible expenditure). Is it intended that transfer providers use mirror accounting for funding in arrears, as under ED71 transfer recipients can recognise amounts owing under such arrangements between payment milestone or due dates?
- Multi-year grants – do these have to be recognised for the entire grant upfront?

I believe that transfer providers should not recognise a transfer provider's binding arrangement asset representing a prepayment of resources to third-party beneficiaries when the transfer arrangement has present obligations and not performance obligations – and the funding is paid in advance. ED72 should be clarified that it does not require such mirror accounting.

It is common for current practice that transfer providers only recognise a present obligation when a payment obligation arises, e.g. those identified in AG92:

(a) At the commencement of the research project;
(b) Periodically (i.e., at set dates) throughout the research project;
(c) As key project milestones are achieved; or
(d) At the completion of the research project.

The consequence is that transfer providers do not:

- Recognise an expense for unbilled activities (e.g. specified activities and eligible expenditure spent that is reimbursable) that would mirror the transfer recipient recognising a receivable for payments in arrears for performing such activities.
- Recognise an expense for future payments in a multi-year grant

Examples of payment arrangements in arrears include:

- 50% upfront, and the remaining 50% when 50% complete (while technically in advance of spending, it is in arrears in the sense that the funding is not all in advance, and that there is a further payment milestone)
- 30% upfront, and 60% during construction, and 10% when final completion sign-off is achieved. The 60% may be paid as and when the transfer recipient spends the construction (or other) costs, or may be due at the end of completion.

ED72 should be clarified for common situations of payments in arrears as to when there is a present obligation. I believe that a present obligation exists when a payment milestone is reached. Because sometimes that milestone is dependent on the actions of the transfer recipient, rather than the passage of time, that milestone payment may require the transfer recipient to notify the transfer provider for the transfer provider to know that there is a present obligation.

For similar reasons to the "monitoring" issue and timing of acquittals issues I have raised on the mirror accounting for ED70, transfer providers may not have up-to-date / real-time information of the actions of transfer recipients. Current practice appears to be waiting until the claim is made before a liability is recognised (or time if it is for example a payment after a certain period of time).

For a multi-year grant, the future payments are often linked to acting in good faith – i.e. even if the future payments are not linked to ED70 performance obligations, there is a requirement that the transfer recipient complies with the grant agreement. I.e. there is no conditional obligation to pay cash (i.e. not a financial liability). I believe that at the commencement of the agreement, there is no present obligation to make all future payments, as future payments are dependent on acting in good faith etc.

I discussed above under Specific Matter for Comment 6 the issue of social benefit bonds and the delays between performance, measurement and payment. While I believe the social benefit bonds (at least those I have been involved with) are performance obligations, if they are not under ED70, then that issue should be covered under transfers with present obligations

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?

I include my views on appropriations, and more specifically “exit” or “termination for convenience” clauses in my response to ED71, with come of those copied into ED70.

I believe that a present obligation is not dependent on appropriations beng approved. I have expressed my views on the timing of present obligations earlier.

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?

I make few comments as I have not spent time on this topic.

As I note in Specific Matter for Comment 4, I do not agree with the accounting for transfer expenses with performance obligations. If all transfer expenses were recognised when there is an present obligation to make the payment, I believe the disclosures would be a lot simpler.

Other comments

As I note in Specific Matter for Comment 4, I do not agree with the accounting for transfer expenses with performance obligations.

I include comments below on the following issues, based on my experience with implementing the Australian equivalent of IFRS 15:

a) Contributions from owners (paragraph 6)

b) Transfer expenses with performance obligations

    i) Right to payment for performance completed to date para 36(c), 38

    ii) Methods for Measuring Progress (paragraph 42) (input method)

    iii) Methods for Measuring Progress (paragraph 42) (exclusion of some costs)

    iv) Variable consideration (paragraph 54)

    v) Variable consideration constraint (paragraph 56 and 57)

    vi) Consideration receivable by transfer provider (paragraph 70)

c) Transfer expenses without performance obligations

    i) Variable consideration constraint (paragraph 108)

    ii) Subsequent measurement – Paragraphs 117 and 120

d) Research

a) Contributions from owners (paragraph 6)

Para 6(a). The reference to contributions by owners implies control via share ownership. In many public sector arrangements, control can be through means other than shares, such as non-share membership of a constituting document, or from control provisions through ministerial directives.

Para 6(b) reinforces the focus on share ownership, by referring to “earlier investments”.

b) Transfer expenses with performance obligations

i) Right to payment for performance completed to date para 36(c), 38

Paragraphs AG46 onwards provide some guidance. This guidance is written on the assumption of payments in arrears. Further guidance or examples should be given for payments in advance, and where the recipient is entitled to keep funds (i.e. not repay funds) that have been spent satisfying the performance obligation.

ii) Methods for Measuring Progress (paragraph 42) (input method)

Paragraph 42 references paragraphs AG50 – AG52 for guidance for using outputs and input methods. However, those paragraphs only include guidance for output methods. Guidance for input methods is not provided. ED72 is missing the mirror paragraphs of ED70 paragraphs AG59 and AG60 (IFRS 15 paragraphs B18 and B19). Input methods is important as it is the most common way to measure performance – i.e. tracking the cash spent.

Paragraph AG25 appears to explain the missing reference to input method (transfer provider not having access to the transfer recipient’s inputs). Paragraph AG25 appears to allow use of the input method if the information is available – though the application is confusing and it is not clear what is required:

> However, where a transfer provider has access to such additional information, it may apply the guidance in [draft] IPSAS X (ED 70) for which there is no equivalent guidance in this [draft] Standard in accounting for transfer expenses with performance obligations, provided such guidance does not conflict with the requirements of this [draft] Standard and that

the transfer provider makes any related disclosure required by [draft] IPSAS [X] (ED 70).

iii) Methods for Measuring Progress (paragraph 42) (exclusion of some costs)

Paragraph 43 is not consistent with what would be the mirror of paragraphs AG59 and AG60. Under paragraph 43 the measure of progress includes all goods or services transferred to the third-party that the transfer recipient acts as principal. ED70 paragraph AG60 excludes costs of some “pass-through” goods and services – i.e. costs that do not represent performance undertaken.

iv) Variable consideration (paragraph 54)

The requirements of paragraph 54 are drafted on the assumption of the transfer provider being required to pay consideration to the transfer recipient. Many public sector arrangements are paid in advance, so the assessment relates to the measurement of the consideration already paid (transfer provider’s binding arrangement asset).

v) Variable consideration constraint (paragraph 56 and 57)

The constraint for binding arrangements with performance obligations is drafted as probable, not the highly probable of ED70 paragraphs 55 and 56. Was this intended? The distinction is not identified in the Basis for Conclusions.

The constraint for transfer expenses without performance obligations does have the highly probably constraint (paragraph 108).

What is the intention of how the constraint will operate in an expense environment? I use below as an example, where it is probable, but not highly probable, of the additional consideration being made.

For the revenue constraint the transfer recipient is likely to understate the revenue (understate the receivable if in arrears / overstate the payable if in advance) compared to fair value / expected value. That is, if the consideration is probable, but not highly probable, it is not recognised. How is ED72 intended to operate? Should the consideration that is probable, but not highly probable, be recognised as an expense? It is not clear how ED72 operates for the expense constraint, but on a conservative basis (similar to that used for revenue recognition) it would be the reverse of ED70 accounting for the revenue constraint – i.e. wanting to understate the asset (recipient liability if in advance) and overstate the liability (recipient receivable if in arrears).

vi) Consideration receivable by transfer provider (paragraph 70)

I had trouble working through this without an example

c) Transfer expenses without performance obligations

i) Variable consideration constraint (paragraph 108)

N.B. Constraint for performance obligations is probable (paragraphs 56 and 57) – refer my comments earlier.

What is the intention of how the constraint will operate in an expense environment? I used above)transfer expenses with performance obligations) as an example, where it is probable, but not highly probable, of the additional consideration being made.

Would an amount that is probable of payment, but not highly probable, be accrued?

ii) Subsequent measurement – Paragraphs 117 and 120

I found the provisions confusing. I do not understand the type of liability that paragraph 120 is trying to address.

Does paragraph 117 (settlement of a non-financial liability for a transfer expense without performance obligation) require the difference between the amount accrued and amount paid to be recognised as a gain / loss in operating surplus, or an adjustment against the expense originally recognised?

I am also confused about including (non-contractual) liabilities that are not transfer expenses in the standard on transfer expenses.

d) Research

Paragraphs AG92 and Illustrative Example 2 (paragraph IE8 onwards) are drafted on the basis that research grants (that do not involve the transfer of the IP) are not performance obligations. As I noted in my response to ED70, I believe that many research "grants" are funding arrangements for purchased services (i.e. with performance obligations) and should be accounted for under ED70.