01 November 2020

BOTSWANA INSTITUTE OF CHARTERED ACCOUNTANTS COMMENT LETTER TO EXPOSURE DRAFT 72 – TRANSFER EXPENSES

Introduction

The Botswana Institute of Chartered Accountants ("BICA") is a statutory body established by Accountants Act, 2010 for the regulation of the accountancy profession in Botswana. The BICA mission is to protect public interest through promoting the accountancy profession, supporting accountants, facilitating quality professional accountancy services through the monitoring and regulation of professional accountants.

The Institute appreciates the opportunity to contribute towards IPSASB's Exposure Draft 72 – Transfer Expense. We provide our comments to each specific question as per the exposure draft.

Should you wish to have further engagements please do not hesitate to contact the undersigned.

Yours Faithfully

Signed electronically	*Signed electronically*
Mosireletsi M Mogotlhwane ACA	**Edmund Bayen**
Manager –	Director -
Technical and Public Sector	Technical and Public Sector
Accounting Services	Accounting Services

RESPONSES TO SPECIFIC QUESTIONS

1.0. 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?

Points to consider in making the decision

BC4 – BC10, which make references to paragraph 3 – 7 of the exposure draft, are aimed at explaining the reasoning behind the decision to limit the scope of the ED. Central to the limitation in scope is the definition assigned to transfer expenses thus

"A transfer expense is an expense arising from a transaction, other than taxes, in which an entity provides a good, service, or other asset to another entity (which may be an individual) **without directly receiving any good, service, or other asset in return**." Emphasis is not part of the ED but meant to reinforce the point.

The ED also specifically highlights the following as being out of scope

Operating leases as defined in IPSAS 13, Leases;

(b) Provisions as defined in IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets;

(c) Collective services and individual services as defined in IPSAS 19;

(d) Employee benefits as defined in IPSAS 39, Employee Benefits;

(e) Concessionary loans as defined in IPSAS 41, Financial Instruments;

(f) Social benefits as defined in IPSAS 42, Social Benefits;

(g) Insurance contracts (see the international or national accounting standard dealing with insurance contracts); and

(h) Share-based payments (see the international or national accounting standard dealing with share-based payments).

(i) Contributions from owners and distributions to owners as they do not meet the strict definition of a transfer expense

(j) Recognition and initial measurement of other non-contractual payables.

(k) Subsequent measurement of other non-contractual payables addressed by another standard.

(l) Any separation and /or initial measurement criteria in a binding arrangement specifically addressed by another standard

The in-scope matters identified by the ED include the following

(a) Any expense that meets the definition of a transfer expense
(b) Subsequent measurement of other non-contractual payables
(c) Transfer expenses incurred for capital transfers (as defined in ED 71)

BC11 – BC15, which make references to paragraph 8 – 9 of the exposure draft, provides the rationale that the IPSASB used to determine which definitions in other standards would be used as they are and which would be either slightly amended or entirely defined in ED 72 to further clarify issues.

Recommendations

In view of the foregoing we agree that the scope and definitions used in ED 72 are clear and may not need any further changes

2.0. 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?

<u>*Points to consider in making the decision*</u>

ED 72 was issued as part of the IPSASB Revenue project and is related with ED 70, Revenue with Performance Obligations, and ED 71, Revenue without Performance Obligations. These 3 EDs are not only aimed at replacing IPSAS 9, Revenue from exchange transactions and IPSAS 23, Revenue from Non-exchange transactions (Taxes and Transfers) but to further clarify issues that both users and preparers of financial statements were experiencing in interpreting/implementing the 2 standards.

Recommendations

In view of the foregoing and to ensure consistence in the use and interpretations of the standards, we concur with the decision of the IPSASB to apply the distinction between transfer expenses with performance obligations and transfer expenses without performance obligations.

3.0. 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?

Points to consider in making the decision

ED 70 defines a performance obligation as a promise in a binding arrangement with a purchaser to transfer to the purchaser or third-party beneficiary either:

(a) A good or service (or a bundle of goods or services) that is distinct; or

(b) A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the purchaser or third-party beneficiary.

The Public Sector Performance Obligation Approach requires that a transfer expense be accounted for as transfer expense with performance obligation when all the following criteria are met

(a) The parties to the binding arrangement have approved the binding arrangement (in writing, orally or in accordance with other customary practices) and are committed to perform their respective obligations;
(b) The transfer provider can identify each party's rights regarding the goods or services to be transferred;
(c) The transfer provider can identify the payment terms for the goods or services to be transferred; and
(d) The transfer provider can identify the transfer recipient's performance obligations and monitors the satisfaction of those performance obligations throughout the duration of the binding arrangement.

AG27 reasons that if a transfer provider does not monitor the transfer recipient's satisfaction of its performance obligations, the transfer provider would not have reliable information about when a transfer expense arises. Without such information, the recognition of an expense could be inappropriately delayed thus, where the transfer provider does not monitor the transfer recipient's satisfaction of its performance obligations, a transfer provider shall account for the transfer expense as a transfer expense without performance obligations.

Recommendations

Reading section 13d of the ED and AG27, the key operand between whether to account for a transfer expense with or without performance obligations rests on the concept of monitoring. The ED does not both to define or set parameters of what monitoring is and therefore allows the possibility of abuse with different interested parties interpreting monitoring in whatever way that benefits their intentions. Such an eventuality would lead to distortion of financial statements thus affecting comparability.

We would therefore recommend that for purposes of section 13d the term monitoring be defined as follows

A transfer provider shall be deemed to satisfy section 13d if they receive performance obligation satisfaction reports from the transfer recipient either

a) a monthly report for a project with a short-term duration or quarterly or bi-annual reports for a project with a long-term duration

4.0. Specific Matter for Comment 4

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

Points to consider in making the decision

The key question of consideration here is determining the most faithful presentation of such information in line with the Conceptual Framework.

Three key issues arise being

(a) when and how the existence of an asset is established,
(b) whether the requirement for a transfer recipient to transfer goods or services to the specified third parties satisfies the definition of a resource as "an item with service potential or the ability to generate economic benefits."
(c) Whether the transfer provider presently controls the resource as a result of a past events

Guidance on these 3 issues is sufficiently provided for in paragraphs BC 16 – BC34 and needs no repetition here.

Recommendations

We are therefore in agreement with the IPSASB on the recognition and measurement requirements for transfer expenses with performance obligations starting with the recognition of an asset followed by the expense recognition as the transfer recipient satisfies the performance obligations.

5.0. 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.

Points to consider in making the decision

Recognition of expenses in ED 72 Transfer expenses with performance obligation requires the use of the Public Sector Performance Obligation Approach (PSPOA) whose steps are

Step 1: Identifying the binding arrangement with a transfer recipient (see paragraphs 13–23);

Step 2: Identifying the transfer recipient's performance obligations in the binding arrangement (see paragraphs 24–32);

Step 3: Determining the transaction consideration (see paragraphs 47–71);

Step 4: Allocating the transaction consideration to the transfer recipient's performance obligations in the binding arrangement (see paragraphs 47 and 72–85); and

Step 5: Recognizing expenses when (or as) the transfer recipient satisfies a performance obligation (see paragraphs 33–46).

This stepped approach requires users of the standard to determine specific key issues at each step thus making it easy to finally decide whether to recognize the expense/asset or not.

Measurement of Transfer expenses with performance obligation is guided by Step 3 and Step 4 of the PSPOA and a detailed explanation of how to apply these two steps is provided for under paragraphs 51 – 89 of the ED.

Recommendations

Other than the issues raised in SMC 3 on monitoring and the possibility of material errors due to key sources of estimation uncertainty, we don't anticipate that there will be any difficulties in applying the recognition and measurement criterion provided by the ED.

6.0. 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?

Points to consider in making the decision

The recognition criteria is guided by 2 key events namely

a) the existence of a present obligation on the part of the Transfer provider. ED 71 defines a present obligation as 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. So, when this occurs the transfer provider will be required to recognize a liability representing its obligation to transfer the resources.
b) the loss of control of the resources by the transfer provider. Loss of control will usually take place when the transfer provider transfers the resources to the transfer recipient. When this happens the Transfer provider derecognizes the resources so transferred in accordance with other standards.

The measurement criteria adopted by this ED follows the key events that lead to the recognition criteria namely at the point a present obligation is created or at the point that loss of control of the resources takes place.

The use of the best estimate of the costs likely to be incurred by the transfer provider to settle the liability arising from the present obligation or of the carrying amount of the resources transferred when control is lost are the recommended measurement criteria.

Recommendations

We are in agreement with the IPSASB on the recognition and measurement criteria proposed by the ED and would recommend that SMC 6(b) be amended to take cognizance of the use of the best estimate of costs likely to be incurred by the transfer provider to settle the liability arising from the present obligation as measurement criteria.

7.0. 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?

Points to consider in making the decision

The key question to consider here is whether the timing difference in recognition of an expense and revenue between two different entities is appropriate or not.

As noted in SMC 6 a transfer provided can only recognize an expense in the event of either the existence of a present obligation on his part or the loss of control of the resources. On the converse a transfer recipient would recognize revenue without performance obligation when they satisfy the present obligation of the binding agreement. ED 71 however does allow the transfer recipient to recognize a liability upon receipt of the resources until that time it shall fulfill the present obligations.

Recommendations

In view of the foregoing we agree the IPSASB that this lack of symmetry is appropriate in that recognition of expenses by one entity does not automatically lead to the recognition of revenue by another entity. Each entity must determine whether the requirements for recognition of either expenses or revenue are met regardless of the actions of the other entity.

8.0. 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?

Points to consider in making the decision

An appropriation is defined in IPSAS 24, Presentation of Budget Information in Financial Statements, as an authorization granted by a legislative body to allocate funds for purposes specified by the legislature or similar authority thus creating a present obligation to a transfer provider.

Where a transfer provider is prohibited from transferring the promised resources until the appropriation is authorized, the transfer provider shall consider substance over form in determining whether it has a present obligation to transfer the resources prior to the appropriation being authorized.

Present obligation may also be established prior to an appropriation if the enabling authority, together with the exercise of that authority, leads a transfer provider to conclude that the transfer recipient has an enforceable right to those resources, and that the transfer provider consequently has a present obligation to transfer the resources.

Where the authorization of the appropriation may determine when a transfer provider has lost its discretion to avoid proceeding with a transfer, the transfer provider will not have a present obligation and therefore shall not recognize a liability and an expense for the transfer prior to the appropriation being authorized.

Recommendations

Based on the foregoing we agree with the IPSASB that where an appropriation is required, it is important for the Transfer provider to evaluate if they have a present obligation thereby deciding whether to recognize a liability or not.

9.0. 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?

<u>*Points to consider in making the decision*</u>

This ED proposes the following key disclosures

(a) Expenses from transfer expenses;
(b) Binding arrangements for transfer expenses with performance obligations;
(c) The significant judgments, and changes in the judgments, made in applying this [draft] Standard to those binding arrangements for transfer expenses with performance obligations;
(d) Binding arrangements for transfer expenses without performance obligations; and
(e) The significant judgments, and changes in the judgments, made in applying this [draft] Standard to those binding arrangements for transfer expenses without performance obligations.

Recommendations

We propose that the IPSASB considers the following disclosure in addition to the above

(a) The accounting policies adopted for the recognition of transfer expenses from transactions with or without performance obligations;

Other than the foregoing, we agree with the IPSASB on the level of disclosures provided in this ED and neither do we think that there are any proposed disclosure requirements that are unnecessary.