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Chairman
International Public Sector Accounting Standards
Board
International Federation of Accountants

Submitted via website

23 January 2018

Comments to IPSASB's Consultation Paper, Accounting for Revenue and Non-Exchange Expenses

Dear Mr. Carruthers,

We are pleased to respond to the IPSASB's Consultation Paper on Accounting for Revenue and Non-Exchange Expenses.

We support the development of high quality financial reporting standards for the public sector. Against this background we are pleased to note that the IPSASB intends to close the gap on accounting for non-exchange expenses within its suite of standards.

Based on our experience, preparers encounter difficulties when applying the accounting requirements stipulated in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. We therefore encourage the IPSASB to thoroughly assess the practical difficulties in applying IPSAS 23. Recognizing non-exchange revenues based on differing between conditions and restrictions does in our view not cover the full complexity of accounting for non-exchange revenues. Especially the multi-year financing of public sector organisations by grants without conditions can lead to a distortion of an organisation's financial position and financial performance. As a result, we encourage the IPSASB to build on the Conceptual Framework and to discuss the recognition of deferred inflows and deferred outflows in that context.

Another area where we see a need for improvement is accounting for taxes. Whereas we in general support the approach to recognize economic events in the reporting period in which they occur, the discussions around harmonizing public sector accounting in Europe have shown in the area of tax revenues that European Member States face difficulties in the practical application of the taxable event approach. IPSAS 23 foresees the use of statistical models to recognize tax revenues based on the taxable event.

In practice it does not seem clear how such statistical models should be applied and how they should be designed. Against this background we suggest that the IPSASB thinks of more detailed Implementation/Application Guidance especially for this area in the further course of its project. We therefore concur with the view that the accounting treatment of revenue transactions that do not contain performance obligations or stipulations (i.e. Category A transactions in the Consultation Paper, for example taxes and transfers) should be addressed in an updated version of IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

With regards to IFRS convergence we fully support the IPSASB in converging IPSASs with corresponding IFRSs. For the sake of consistency between the public and the private sector, **we see merit in having a Public Sector Performance Obligation Approach (PSPOA) for transactions with performance obligations or stipulations which do not have all the characteristics of a transaction in the scope of IFRS 15 (i.e. Category B in the Consultation Paper).** However, we think that the implications of applying a PSPOA in the public sector would need to be further adapted to the public sector specifics. We would recommend that the IPSASB further explores grants with timing requirements as well as an "other economic phenomena-approach" (deferred inflow/deferred outflow-approach) in the context of the PSPOA.

Based on our current experiences with IFRS 15 in the public sector we would like to note that preparers will face considerable efforts in implementing IFRS 15. Especially the analysis of contracts can lead to significant efforts. However, this does not imply that we would reject IFRS 15 as a basis for Category C revenue transactions. We would rather recommend to consider the complexity of implementing IFRS 15 concepts in the public sector when determining the effective date of a future standard.

With regards to accounting for non-exchange expenses, we would support a mirror approach to the accounting for non-exchange revenues.

Please do not hesitate to contact Thomas Müller-Marqués Berger or Dr. Jens Heiling in case of any additional questions or remarks.

Sincerely,



Thomas Müller-Marqués Berger
Partner



ppa. Dr. Jens Heiling
Senior Manager

Annex – detailed responses

Preliminary View 1 (following paragraph 3.8)

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:

- ▶ Involve the delivery of promised goods or services to customers as defined in IFRS 15; and
- ▶ 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.

EY's response: We agree to replace IPSAS 9, *Revenue from Exchange Transactions* and IPSAS 11, *Construction contracts* by a new IPSAS based on the performance obligation approach stipulated by IFRS 15, *Revenue from Contracts with Customers*. We are of the view that convergence of IPSAS with the corresponding IFRS is a strategic priority of the IPSASB.

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.

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

EY's response: We agree with IPSASB's PV 2. We concur with the view that the accounting treatment of revenue transactions that do not contain performance obligations or stipulations (i.e. Category A transactions in the Consultation Paper) should be addressed in an updated version of IPSAS 23. Concerning the update we refer to our cover letter above.

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:

- ▶ Social contributions; and/or
- ▶ 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.

EY's response: EY is of the view that additional guidance should be provided in an updated version of IPSAS 23 on social contributions and taxes where there is a separation between the timing of the taxable/social contribution event and the collection of taxes/social contributions. With regards to accounting for taxes in accordance with IPSAS 23 we would like to underline that in practice it does not seem clear how statistical models should be applied for the recognition of tax revenue and how they should be designed. Against this background we suggest that the IPSASB thinks of Implementation/Application Guidance in the further course of its project. Furthermore, we have experienced that there are also problems in terms of measurement of tax revenue, e.g. the

determination of the best estimate of tax revenue in the context of having sufficient staff capacity to perform such estimations. Given the fact that IFRS 15 changes the accounting for “uncollectability” of revenues (debiting revenue instead of recognizing an expense for doubtful debts), we would encourage the IPSASB to develop guidance on this matter.

With regards to tax expenditures and expenses, more detailed guidance would be helpful, as well as providing some practical and illustrative examples. The guidance provided in the standard is not sufficient and clear definitions, distinction as well as accounting guidance for both of them would be considered as valuable.

Also the current guidance in IPSAS 23 on accounting for social contributions is very limited. We would suggest that an updated IPSAS 23 should have a specific section on accounting for social contributions in the body of the Standard. In addition to that, similarly than for taxes, additional Implementation/Application Guidance on accounting for social contributions should be provided (e.g. on the use of statistical models).

In addition EY has encountered the following issues in accounting for transfers under IPSAS 23:

- 1) Transfers with performance obligations that are not a condition according to IPSAS 23. In practice we have experienced difficulties in fulfilling the matching principle (i.e. recognizing the expense in the same period as revenues). The same applies to donations of tangible assets. Applying the matching principle is not possible, if no condition is attached to the donated asset. In such a case, revenue recognized initially is not matching with the donated asset's depreciation within the receiving entity.
- 2) We also see a need for additional guidance for consolidation procedures regarding IPSAS 23 - from higher level to lower level entities. At present, the lack of guidance raises difficulties with consolidation regarding transfers. We would urge the IPSASB to provide a coherent approach;
- 3) We would encourage the IPSASB to provide further guidance on determining best estimates for subsequent measurement of transfers;
- 4) We also see a need for clear guidance and/or illustrative examples for the contractual/non-contractual distinction (in accordance with IPSAS 28 AG 20-21) that is also relevant for IPSAS 23 - for example, for the relationship between taxpayers and tax authorities for repaying tax debts in certain terms or court decisions regarding contractual arrangements.

Preliminary View 3 (following paragraph 4.64)

The IPSASB considers that Category B transactions 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.

EY's response: We support the PSPOA for transactions with performance obligations or stipulations which do not have all the characteristics of a transaction in the scope of IFRS 15 (i.e. Category B in the Consultation Paper). For Category B transactions, we welcome an accounting approach based on the IFRS 15 five-step model (i.e. the performance obligation approach) but adequately adapted for the public sector environment. In this context, the IPSASB could reconsider the current conditions/restrictions-approach of IPSAS 23 as well as the accounting for transfers with timing restrictions.

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.

EY's response: For the sake of consistency between public and private sector accounting, we see merit in having a Public Sector Performance Obligation Approach (PSPOA) for transactions with performance obligations or stipulations which do not have all the characteristics of a transaction in the scope of IFRS 15 (i.e. Category B in the Consultation Paper). However, we think that the implications of applying a PSPOA in the public sector would need to be further adapted to the public sector specifics. We would recommend that the IPSASB further explores grants with timing requirements as well as an "other economic phenomena-approach" (or a deferred inflow/deferred outflow-approach) in the context of the PSPOA.

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;
- Option (e) - Recognize transfers with time requirements in net assets/equity and recycle through the statement of financial performance.

Please explain your reasons.

EY's response: We would favor option d). In line with the Conceptual Framework, received transfers with time requirements should be classified as other obligations. Alternatively, we would like to encourage the IPSASB to reconsider if time requirements could be regarded as a condition. In our view, time requirements always come together with specific performance obligations which could then be regarded as a condition.

Specific Matter for Comment 4 (following paragraph 4.64)

Do you consider that the option that you have 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.

EY's response: Yes, we are of the view that option (d) in SMC 3 should be used in combination with Approach 1 Option (a). Additional guidance would in our view be helpful, especially for the distinction of exchange/non-exchange transactions as well as further guidance and/or illustrative examples for the contractual/non-contractual distinction (which could be exchange/non-exchange).

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.

EY's response: Yes, we would encourage the IPSASB to develop more guidance on accounting for capital grants, especially for grants with timing requirements concerning the usage of the financed assets. Also providing a definition for capital grants would be considered as helpful in that context.

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.

EY's response:

As outlined before, we would encourage the IPSASB to develop clear guidance and definition of capital grants and criteria for recognition of them to identify them correctly. As outlined earlier, the Consultation Paper does in our view not discuss problems with regards to the matching principle and accounting for capital grants. We would encourage the IPSASB to discuss the possibility of accounting for other obligations/other resources or deferred inflows/deferred outflows respectively in that context.

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.

EY's response:

As we believe that options within the IPSAS accounting framework should be reduced we would favor approach b). However, we see some practical difficulties in applying that approach and for some entities this might also be onerous. A possible approach could be to require to recognize only services-in-kind that are offered on an open and transparent market (i.e. professional services). As the recognition criteria for such services would have to be applied (e.g. reliable measurement), other services-in-kind than professional services should generally not be recognized.

As a consequence, it would be helpful to develop more specific guidance for the recognition and measurement of services-in-kind.

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.

EY's response: Yes, we agree with IPSASB's Preliminary View 5. With regards to the definition of universally accessible service and collective services we would like to mention that in our view this distinction would need to be further specified in an Exposure Draft.

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.

EY's response: Yes, we agree with IPSASB's Preliminary View 6.

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 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.

EY's response: As we favor a symmetrical approach for the accounting of non-exchange expenses, we agree with IPSASB's PV 7. As for revenues, we would encourage the IPSASB to reconsider the current conditions/restrictions-approach of IPSAS 23 as well as the accounting for transfers with timing restrictions. A deferred outflow/other resources-approach might be an appropriate way forward in our view.

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.

EY's response: EY agrees in principle with IPSASB's view that initial measurement of non-contractual receivables should be at face value (legislated amount) of the transaction with any amount expected to

be uncollectible identified as an impairment. This approach supports accountability and is in the public interest. However, we suggest that the IPSASB provides further guidance on how to determine the face value less any amount to be uncollectible. In addition, we would encourage the IPSASB how this approach would relate to the application of statistical models to determine tax revenue according to IPSAS 23.

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.

EY's response: From a true and fair point of view we would clearly favor the fair value approach. However, we would underline the complexities and administrative burden involved in such an approach. In case that entities are using statistical models to determine tax revenue or revenues from social contributions, we would encourage the IPSASB to provide guidance on the practical aspects when using the fair value approach in the context of statistical models (or other approaches such as the tax assessment approach).

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.

EY's response: For subsequent measurement of non-contractual payables, we would favor using the best estimate of the amount required to settle the present obligation at the reporting date, using discounted cash flows where appropriate (i.e. option (a)) as this approach would be in accordance with the Conceptual Framework and produces understandable information, as outlined in para. 7.42 of the CP.