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Ian Carruthers
Chairman
International Public Sector Accounting
Standards Board
International Federation of Accountants

Submitted via website

1. November 2020

Comments to IPSASB's
ED 72 "*Transfer Expenses*"

Dear Mr. Carruthers,

We are pleased to respond to the IPSASB's ED 72 "*Transfer Expenses*".

We appreciate that the IPSASB issued ED 70 "*Revenue with Performance Obligations*", ED 71 "*Revenue without Performance Obligations*", and ED 72 "*Transfer Expenses*" in parallel for comment. Given their importance for public sector accounting, we encourage the IPSASB to continue working on the three Standards in parallel and to issue them simultaneously.

We have also noted that currently, principal-agent-relationships are only covered in ED 70 in the Application Guidance. Given the practical importance of principal-agent-relationships in the context of revenue without performance obligations, we suggest that the IPSASB also includes guidance or even principles in a future Standard on Revenue without Performance Obligations and the future Transfer Expenses Standard.

Should you need any further information, please do not hesitate to contact us.

Sincerely,

Thomas Müller-Marqués Berger
Partner and Global Leader of Public Sector Accounting

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft

Annex – detailed responses

ED 72 "*Transfer Expenses*"

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?

We agree that the scope of this [draft] Standard is clear defining transfer expenses as "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". Although paragraph 5 explicitly excludes from the scope the social benefits covered in IPSAS 42, it might be worth explaining better the relationship between both standards. Given the broad definition of transfer expenses, constituents might think that the cash transfers covered in IPSAS 42 are also a type of transfer expenses.

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?

We agree with the proposal to distinguish between transfer expenses with performance obligations and transfer expenses without performance obligations, mirroring the proposals in ED 70 and ED 71. Please note that most of the [draft] standard refers to the present obligation from the transfer recipient perspective, however in ED 72.91 Recognition, the [draft] standard refers to the present obligation of the transfer provider to transfer the resources. The use of the same term from different perspectives (transfer provider and transfer recipient) might be confusing.

ED 72, 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?

We disagree with the proposal 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", for the following reasons:

- The proposal implies a continuous assessment of the satisfaction of the performance obligations.
- The requirement can be perceived to be too operational and too specific (only for transfer of goods and services to third party beneficiaries) to be included in the core text of the standard.
- This might lead to asymmetries in the accounting of the transfer recipient and the transfer provider.
- Entities could use this proposal as an argument for avoiding the application of the five steps of the Public Sector Performance Obligation Approach (PSPOA).

Some suggestions to address this issue are:

- The inclusion of a principle that the expenditure relating to a transfer with performance obligations should be recognized on the basis of the transferor obtaining evidence of the satisfaction of these obligations by the recipient (instead of a continuous monitoring). For instance, the receipt of regular reports with updates on the satisfaction of the performance obligations, or the receipt of evidence that the delivery of the goods and services to the third-party beneficiaries occurred, could be perceived as being sufficient indicators for the fulfillment of the performance obligations. Doing this would achieve the same objective as requiring monitoring, but without being as restrictive or prescriptive as to how frequent such monitoring should occur and will allow a degree of reasonable judgement on the part of preparers (and auditors) to assess whether the evidence is available to support the recognition of the expense.

- It is advisable that the reporting obligation on the satisfaction of the performance obligations is placed on the transfer recipient. This could be part of the binding arrangement. In this context, the standard could include some implementation guidance or illustrative examples, on how the transfer provider could mitigate the risk of not receiving timely information on the satisfaction of the performance obligations.

ED 72, Specific Matter for Comment 4:
This [draft] Standard proposes the following recognition and measurement requirements for transfer expenses with performance obligations:

- 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
- 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?

We agree with the recognition and measurement requirements for transfer expenses with performance obligations. However, they might be difficult to implement because it could create a gap between the budget execution and accounting. This will be especially an issue for jurisdictions using integrated financial administration systems. The requirements can also affect the timeliness and reliability of the accounting information, because the transfer provider will depend on the third-party beneficiary to confirm that they received the goods and/or services in order to recognize the expense.

More guidance is required to help transfer providers in distinguishing if the transfer recipient is an agent or not and how to monitor the satisfaction of the performance obligations. From the perspective of the transfer provider, one might argue that the principal-agent issue is not that relevant, because either way they would still recognize an expense (it is merely the counterparty to that expense that changes depending on whether the transfer recipient is a principal or an agent). Therefore, the principal-agent issue could be considered more likely to be a problem from the transfer recipient's perspective as it affects whether they recognize the revenue gross or net. However, from the perspective of the transfer provider, we have found in practice that this has a big impact on how the transactions are recorded and what source documentation is retained. It could, for example, impact the classification of the expense as a single transfer to another entity vs more disaggregated transfers to beneficiaries, and, from an audit perspective these two scenarios would have different source documents. It would also impact the timing of the recognition of the expense. If the transfer recipient is an agent, then the expense would only be recognized once the resources are transferred to the 3rd party beneficiaries and any resources held by the agent would be a receivable in the books of the transfer provider. But if the recipient is a principal, then it means that the obligation to 3rd party beneficiaries is the recipient's obligation in terms of its mandate / binding arrangement. In this case, it is not clear why the recognition of the expense in the transfer provider's books should be delayed under such circumstances. One might argue that in such situation, the transfer provider has fulfilled its obligation (to the recipient as the principal), and should recognize the expense in full.

ED 72, 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.

Given the complexity of the PSPOA, entities will likely find excuses not to apply it and rather recognize the expenses as if the transfers were without performance obligations.

- Suggestion A – consider removing the condition of fulfillment of all the criteria in paragraph 7.13 in order to apply the PSPOA.
- Suggestion B – consider changing the requirement of continuous assessment of the satisfaction of the performance obligations and replace it with a more feasible assessment such as receiving regular reporting or evidence that the goods and services were delivered.

The implementation of the PSPOA would require entities to make important adaptations to their information systems, especially if they have integrated modules of budget and accounting.

- Suggestion A – consider issuing a IPSASB staff Q&A document that discusses this issue and provides potential solutions
- Suggestion B – consider addressing the issue and provide potential solutions in the implementation guidance

When the transfer provider recognizes and measures the expenses as if they were without performance obligations, this will lead to asymmetries in the accounting with the transfer recipient. If the transfer provider and transfer recipient belong to the same reporting entity, this asymmetry will create challenges in the consolidation.

- Suggestion – consider removing the condition of fulfillment of all the criteria in paragraph 7.13 in order to apply the PSPOA.

ED 72, Specific Matter for Comment 6:
This [draft] Standard proposes the following recognition and measurement requirements for transfer expenses without performance obligations:

- 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
- 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?

We agree with the recognition and measurement requirements for transfer expenses without performance obligations when there is no present obligation. However, when the transfer recipient has the present obligation of fulfilling specified activities or incurring eligible expenditures, there might be argument for the transfer provider recognizing an asset reflecting the expected fulfillment of this present obligation by the transfer recipient. This would allow maintaining symmetry between the transfer provider and the transfer recipient. Although there are arguments that support the idea that the present obligation of the transfer recipient does not give rise to an asset on the transfer provider side, there are jurisdictions in which there is an indirect control of the resources. For instance, we came across cases in practice, where if the transfer recipient does not satisfy the performance obligations, the transfer provider can instruct the National Treasury to freeze the funds available in the bank account of the transfer recipient until the performance obligation is satisfied.

ED 72, 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?

We consider this lack of symmetry is appropriate because conceptually it is consistent to the IPSASB's Conceptual Framework. However, it might cause consolidation issues when the transfer recipient and the transfer provider belong to the same reporting entity (for instance, the elimination of inter-company accounts, these items are usually very material).

ED 72, 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?

We agree with the proposal of recognizing a liability prior to the appropriation being authorized if there is a present obligation to transfer the resources. However, this represents an operational issue (legal matter) to implement in practice. It might be against the national laws to enter into a present obligation without having been authorized to spend the money –

either via appropriations or via a specific budget item in an approved budget. Furthermore, it breaks the budget-accounting integrity, and usually the integrated financial administration system would prevent to do such postings. For these reasons, it is important to offer clarity on the definition of "appropriation being authorized", as this is a legal concept that could have different meanings. It is suggested to consider the substance of this authorization and whether it can, for example, be over-turned or withdrawn without further legal processes. In some jurisdictions authorization by a particularly authority / legal process might be the best indicator of the true substance of the obligation. Finally, we recognize that this operational issue should not hinder the present obligation being recognized in the accounting. In these cases, accounting has an indicator and correction function for malfunctioning of operational processes.

ED 72, 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?

We agree the disclosure requirements in this [draft] Standard are appropriate to provide users with sufficient, reliable and relevant information about transfer expenses. We do not think there are additional disclosure requirements that should be included, because the list is already very comprehensive. We think it might be appropriate to reduce some disclosure requirements, especially those in which the transfer provider depends on the information that the transfer recipient provides. We support that for the disclosure requirements that are unnecessary, the paragraph 130 already provides some relief to preparers specifying that "a specific disclosure requirement in this [draft] Standard needs not be satisfied if the information is not material."