P O Box 7001
Halfway House
Midrand
1685
Tel. 011 697 0660
Fax. 011 697 0666
www.asb.co.za

The International Public Sector Accounting Standards Board

277 Wellington St. West
Toronto, ON
M5V 3H2

Submission via website

30 October 2020

Dear Ross

COMMENTS ON ED 72 ON *TRANSFER EXPENSES*

We welcome the opportunity to provide comments on ED 72 on *Transfer Expenses*. We commend the initiative of the IPSASB to develop accounting principles for the last component of what is broadly known as "non-exchange expenses". We believe that there is a high need for accounting principles for these transactions in order to avoid diversity in practice.

The comments outlined in this response have been developed by the Secretariat of the ASB and not the Board.

General

We issued ED 70 on *Revenue with Performance Obligations,* ED 71 on *Revenue Without Performance Obligations* and ED 72 on *Transfer Expenses* as a package of documents for comment locally. We arranged a series of education sessions (eleven), roundtable discussions (ten) and engagements with specific stakeholders (four) to solicit views from preparers, auditors, technical experts, academics, consultants, professional bodies and users.

The level of engagement on the documents and the feedback we received on the proposals was, at times, limited. We believe that this was due to the volume and complexity of the material published for comment. To improve the quantity and quality of the comments received in future, it would helpful if the IPSASB considers constituents' time and ability to engage with the documents.

We also note that it may be useful for the IPSASB staff to consider releasing additional educational material to assist with the understanding of the principles in the Exposure Drafts. We (and our stakeholders) found the At-A-Glance document and the video helpful but note that it only explained the objective and concepts at a very high level. It might be useful to produce additional videos on specific issues within the documents – explained at a more detailed level - to help respondents understand the proposals.

Overall impressions of ED 72

We appreciate the time and effort the IPSASB has invested in developing the proposals in ED 72 and again re-iterate the need for guidance for these transactions. However, we do not support the proposed public sector performance obligation approach (PSPOA) model for transfer expenses. We do not believe that the complexity of the approach is warranted for expense transactions that involve 3rd parties. Considering that a similar approach is not followed for exchange expense transactions, we believe that inappropriate complexity and emphasis is placed on transactions with 3rd parties. Stakeholders locally also expressed reservations about applying the full approach in IFRS 15 on *Revenue from Contracts with Customers* – which is aimed at commercial revenue transactions - to expense transactions that are public sector specific. See our comments in ED 70 for a list of these issues.

Classification of non-exchange expenses

We are concerned about the complexity of being able to classify goods and services provided to individuals (or households) between IPSAS 19 on *Provisions, Contingent Liabilities and Contingent Assets*, and ED 72.

As the transactions underlying the transfer of goods and services provided to individuals (or households) are essentially the same, we find the classification principles (a) arbitrary from an accounting perspective, and (b) not well enough defined or described. At present, the classification requires a high degree of judgement and is likely to lead to significant issues in practice.

When we discussed the classification principles with stakeholders locally, apart from the national statistical office, preparers indicated that they did not understand the principles. This is because the principles are based on the statistical basis of accounting which accounting preparers are not familiar with and do not understand. Preparers indicated that they would likely need to employ a specialist to assist them with the classification. We believe that this emphasises the current complexity and believe that the time and effort that is likely needed to classify transactions does not add equivalent value to users of the financial statements.

Responses to the proposals in ED 72

Our comments on ED 72 are set out as follows:

- Annexure A – Responses to specific matters for comment
- Annexure B – Other significant issues
- Annexure C – Drafting and other comments

We noticed editorial amendments when reviewing ED 72 but have not included these in our comments. A final editorial review should be done once the text has been finalised.

If you have any questions regarding our response, please feel free to contact me.

Yours sincerely

Jeanine Poggiolini

Technical Director

ANNEXURE A – RESPONSES TO SPECIFIC MATTERS FOR COMMENT

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?

In principle, we support the scope. However, potential issues need to be addressed.

We support that the scope is limited to transfer expenses as discussed in BC4 to BC15. However, potential issues that need to be addressed are outlined below.

Accounting for "residual" transactions

While the basis for conclusions explains that ED 72 is not the "residual" Standard, it is unclear which Standard should be used for these "residual" transactions. Should this be IPSAS 19 on *Provisions, Contingent Liabilities and Contingent Assets,* and if not IPSAS 19, then should an entity apply IPSAS 3 to develop an accounting policy? It would be helpful if this is explained in the basis for conclusions, and/or a staff Q&A.

Taxes

The definition of transfer expenses indicates that taxes are excluded from the definition. Many governmental transfers attract Value Added Tax (VAT) for some levels of government. These are generally transfers without performance obligations and may or may not be subject to binding arrangements as defined in ED 72.

The implication of excluding tax from ED 72 is that an entity would need to use ED 72 to account for the transfer and another IPSAS – presumably IPSAS 19 - to account for VAT. This creates unnecessary complexity. While the scenario listed relates to governmental transfers, other types of expense transactions could have the same issues.

In particular, we note the potential disconnect between the accounting for taxes in IPSAS 19 and the underlying transfer in ED 72:

- Taxes, if recognised using IPSAS 19, would be recognised when there is a past event and the outflow of resources is probable.
- As the underlying transfer is a transaction without performance obligations, it would be recognised in ED 72 when there is a present obligation to transfer resources, or when the resources are transferred as there is no "binding arrangement" as defined (based on paragraph 93).

This means that the timing of the recognition of the tax component may be different to the transfer. For transactions that are not subject to a binding arrangement, there would be a significant difference in the timing of recognition as expenses are recognised when the resources are transferred.

We note our reservations on whether the accounting for transactions without performance obligations and without binding arrangements is appropriate (see our response to specific matter for comment 6).

We believe that the IPSASB should reconsider whether taxes should be included in the scope of transfer expenses. If not, the IPSASB should ensure that the accounting treatment of the component parts of an arrangement is appropriate and provides relevant information to users in the financial statements.

Scope of IPSAS 19 and ED 72 – transactions with individuals to provide goods and services

See Annexure B, issue #1 on the classification of transactions.

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?

Issue #1 –Split between transfer expenses with/without performance obligations?

In principle, we support the notion that transfers with and without performance obligations are different transactions. In particular, we note that transfers with performance obligations are executory contracts that require the clear delivery of promised goods or services in exchange for consideration. Transactions without performance obligations only require the undertaking of some action in return for the transferred resources.

As noted in issue #2, we do not support the proposed accounting for transfers with performance obligations using the PSPOA as currently articulated in ED 72.

Issue #2 –Views on the application of the PSPOA for transfer expenses

We do not support the PSPOA, as outlined in ED 72, for transfer expenses with performance obligations.

Reasons for not supporting the PSPOA

While we appreciate the need for a consistent approach to deal with revenue and expense transactions, we do not support the PSPOA for transfer expenses for the following reasons:

- Key users of the financial statements noted that an approach to the classification of, and accounting for, transactions based on the existence of performance obligations or not does not reflect the way in which the public sector operates. When entities plan, budget and report on transactions, the existence of performance obligations is not important. As a result, the information generated by the financial statements is not useful to users. While the distinction between exchange and non-exchange transactions may be challenging, it better reflects how budget and other decisions are made by public sector entities and governments more broadly.
- The PSPOA is based on the principles of IFRS 15 which is aimed at accounting for commercial revenue transactions. The PSPOA is used in ED 72 to account for what were traditionally considered “non-exchange transactions”, i.e. those where there is no direct exchange of value between the parties. As a result, the scope is limited to transactions that involve the transfer of resources to 3rd party beneficiaries. The PSPOA is complex and difficult to implement and is premised on the existence of executory contracts. We note that this level of complexity is not applied to executory contracts that are exchange

transactions i.e. do not involve 3rd party beneficiaries. As a result, we are unsure why this approach is necessary for such a specific set of transactions.

- There are a limited number of transactions that would meet the definition of transfers with performance obligations in the public sector for a variety of reasons. Firstly, the requirement to implement a monitoring mechanism to ensure that expenses are recognised when performance obligations are satisfied is onerous (see our response to specific matter for comment 3). This means that entities are unlikely to meet the criteria to apply the PSPOA. Secondly, the transactions that require distinct goods or services to be transferred by a transfer recipient to a 3rd party beneficiary are limited in our jurisdiction. They may only be prevalent within certain functions of government. For most entities, if they exist, they are immaterial.

Proposal

We believe that the same accounting principles should be applicable to all transfer expenses. As a result, we support the accounting treatment and the presentation and disclosure requirements for transfers without performance obligations for all transfer expenses (subject to comments raised in other specific matters for comment).

If the PSPOA is retained, we are of the view that certain aspects of the approach, as well as the presentation and disclosure requirements should be modified to simplify it for the types of transactions that is envisaged. See our response to specific matter for comment 5 and 9.

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?

In principle, we support the proposal, with questions or comments about identified issues.

Our concerns about the application of the PSPOA are outlined in the response to specific matter for comment 2.

If the PSPOA is retained, we support that monitoring by the transfer recipient should be a requirement of the criteria to apply the PSPOA in ED 72. As ED 72 requires the recognition of expenses based on when the distinct goods or services are received by the 3rd party beneficiary, if this monitoring is not in place, the model cannot be applied.

Despite support for the principle of monitoring, the following concerns were raised by stakeholders regarding the monitoring to be done by entities.

Status of requirement

The status of the requirement to monitor transfer expense transactions to apply the PSPOA is unclear.

Paragraph 13(d) indicates that the transfer provider "monitors the satisfaction of those performance obligations throughout the duration of the binding arrangement". If an entity does not meet this requirement, then it accounts for the transactions as transfers without performance obligations. In these instances, paragraph 151 requires disclosure about why the transfer provider is unable to monitor the satisfaction of the transfer recipients' performance obligations.

It is unclear whether ED 72 mandates that entities monitor these transactions (see paragraph AG27), or whether entities should only apply ED 72 in the instances where this monitoring is in place. We believe that this is an important clarification as it is likely to result in diversity in how the requirements are applied. It also impacts how entities will approach the implementation of the Standard. Implementing monitoring will have a significant impact on the operations, processes and policies of entities, which will potentially warrant a longer transitional period or delayed effective date.

Monitoring throughout the duration of the arrangement

The requirement in paragraph 13(d) is to monitor throughout the duration of the arrangement.

At present, the level of monitoring undertaken by entities – even for individual arrangements - is at a much higher level, i.e. based on outputs or outcomes rather than monitoring of the provision of distinct goods or services.

At present, if an entity is unable to monitor the satisfaction of performance obligations at the level required on initial recognition, the transaction is treated as a transfer without performance obligations. If an entity can monitor the transaction to the level required in subsequent periods, it is unclear if this would result in a change in how the transaction is treated, i.e. from a transaction without performance obligations to one with performance obligations. The converse is also unclear.

Paragraph 18 indicates that the criteria are assessed at inception and are not reassessed unless there has been a change in facts and circumstances. As the satisfaction of the other criteria would be clear at inception of the arrangement, it may be helpful to clarify the situation when there is a potential change in monitoring in paragraph 18 of ED 72.

Monitoring is likely to be onerous

Stakeholders indicated that the monitoring required is onerous. Two concerns were raised:

- The monitoring that will be required is unlikely to be done by the finance department, but rather the departments responsible for the execution of the arrangement, activity or programme. As a result, it may be difficult for non-financial staff to understand what performance obligations are and when they are satisfied as described in ED 72.
- For the transfer provider to know when goods or services are delivered, it is implied that the transfer recipient would also need an appropriate monitoring system in place. This may not always be the case. Where these arrangements exist in our jurisdiction, the transfer provider and transfer recipient are often public sector entities. Not all of them apply the same accounting Standards, nor are they all necessarily on the same basis of accounting. This could impact the type of monitoring undertaken, and well as the level at which monitoring is performed. It might be useful to indicate that the assessment of whether appropriate monitoring is undertaken is based on the transfer provider's monitoring of the fulfilment of the performance obligations.

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?

We support the proposal.

We agree with the recognition of an asset in circumstances when resources have been transferred to the transfer recipient prior to the satisfaction of performance obligations. As these arrangements are executory in nature, if one entity performs in advance of the other, it creates a right to have goods or services delivered to a 3rd party. As a result, we believe that the definition of an asset is met.

From a user perspective, we note that recognising an asset creates accountability for the resources that have been provided. If an asset is recognised, it means that value was given to another party, and that there are still outstanding obligations. This provides relevant information to users of the financial statements.

Consider updating basis for conclusions

In the conclusion in paragraph BC34, it is indicated that an asset should be recognised. Consider indicating that this is the binding arrangement asset that is referred to in paragraphs 121 to 125.

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.

There are aspects of the approach that are difficult to apply, and we suggest modifying the approach accordingly.

As noted in our comments to specific matter for comment 2, the PSPOA is complex for the types of transactions that it is meant to address. The following areas create unnecessary complexity in accounting for the 3rd party arrangements envisaged by the PSPOA:

Step 1 – Modifications to binding arrangements

While we understand that this may be appropriate in recognising revenue for transactions with performance obligations, we do not believe this level of complexity is necessary for 3rd party expense arrangements. We note that similar requirements to assess modifications do not exist for exchange transactions where an entity acquires goods, services or assets from another party for itself.

The requirements related to "modifications" requires a high degree of "contract" management. We also note that modifications to a binding arrangement would need to be identified by non-financial staff as they, rather than finance officials, are involved in the execution of the specific activity, functions, transactions, etc. Non-financial staff would need to identify potential changes in arrangements that could impact the recognition of past expenditure or to future prices. At a minimum they should be able to flag this for the finance department to consider. As non-financial staff is unfamiliar with accounting requirements, contract modifications would be difficult to implement. We are also not convinced that the information users gain from this information warrants the complexity.

The IPSASB is urged to consider whether this level of complexity is needed for these transactions.

Step 3 – Variable consideration

We note that the concept of a "price concession" is included as part of the factors to consider in "variable" consideration. We are (a) unsure how pervasive price concessions are for expense transactions, and (b) question whether it is appropriate to include this for expense transactions as entities would effectively recognise lower expenses and liabilities on this basis. We also note that it may be difficult to assess whether a price concession exists if it is merely "implicit" in the arrangement.

Step 4 – Allocation of consideration to performance obligations

In terms of ED 72, entities are required to allocate the consideration to the performance obligations based on the stand-alone purchase prices of the goods or services at the inception of the arrangement. Any discounts or variable consideration need to be allocated to the performance obligations. The requirement to use data observable in the market - as well as the alternative approaches in ED 72 - is onerous.

We have also observed that the consideration an entity is required to pay may be more than the sum of the stand-alone purchase prices of the goods or services. There is a rebuttable presumption in ED 72 that indicates that the entire consideration is for the goods or services promised in the arrangement unless it is clear that there is a component that is for something else, e.g. to fund the operations of the transfer recipient. We have recent experience where government has overpaid for goods and services. Following the approach in ED 72, an entity would allocate this excess to the performance obligations. We have three concerns:

- Issue #1 – The basis on which the excess is allocated to the stand-alone performance obligations. There is no guidance in ED 72 for these situations.
- Issue #2 - From an accountability perspective, we question if this is the right answer, and specifically whether the excess should instead be accounted for as an onerous contract. This would potentially provide users with information to hold entities accountable for the amounts paid in excess of the stand-alone purchase price.
- Issue #3 – We question whether this is consistent with the cost of fulfilment in the Conceptual Framework. The cost of fulfilment indicates that the arrangement should be fulfilled in the least costly manner. If government is clearly paying more for goods or

services and the transaction is recognised on this basis, it seems to contradict the current principles in the Conceptual Framework.

We suggest that the IPSASB review the current principles to allocate the consideration to the performance obligations based on the issues raised above.

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?

We partially support the proposals.

The recognition requirements are separated between those transfers that are made subject to a binding arrangement and those that are not based on paragraph 93 of ED 72.

We disagree with the differences in the accounting proposed for those transfers that arise from binding arrangements and those that do not. Our concerns may partly relate to how binding arrangements are defined (see Appendix B issue #2) and applied across the suite of Exposure Drafts.

Issue #1 – The absence of rights and obligations for both parties does not mean there is no liability

We do not support the proposal in paragraph 93 that transfers outside of a binding arrangement are not enforceable by the transfer recipient and no expense (and no liability) is recognised prior to the transfer of resources.

Binding arrangements as defined in ED 72 require rights and obligations to exist for both parties to the arrangement. Entities are often required to make transfers to others where there are not rights and obligations for both parties. Typical examples include transfers made to another public sector entity, charity, etc. In these examples, the transfer provider has an obligation to transfer resources, and the transfer recipient has a right to receive the resources.

Many of these transfers are either outlined in budget legislation, contract or similar requiring the transfer at a particular date or once certain events occur. We believe that the definition of a liability may be met before the actual transfer of resources. This is because a present obligation exists (as a result of a legislative obligation) to incur an outflow of resources (to transfer resources to recipient). We therefore do not support the proposed accounting treatment in paragraph 93 as it is inconsistent with the Conceptual Framework and IPSAS 19.

Issue #2 – Uncertainty about the nature of the obligations in transfers without performance obligations

ED 72 indicates in paragraph .92 that “For a present obligation to exist, the transfer recipient must be able to enforce the transfer of resources by the transfer provider, i.e. there must be a binding arrangement that imposes present obligations on the transfer recipient”.

For the arrangement to be binding, there must be rights and obligations for both parties to the arrangement. As currently drafted, we are unsure how both rights and obligations arise in these arrangements. In ED 71, there is an indication that an entity should fulfil certain obligations by undertaking specified activities or incurring eligible expenditure. There is no similar requirement in ED 72. Although paragraph 90 refers to ED 71 for guidance, the text of ED 72 does not indicate that present obligations arise from specified activities or eligible expenditure. We are therefore uncertain of the types of transactions without performance obligations that would be governed by a binding arrangement.

Stakeholders also noted that they did not believe that there was any difference between the rights and obligations of the parties that either are, or are not, governed by a binding arrangement as defined in ED 72. As an example, an entity transfers resources to a public entity which is required to incur certain expenditure in terms of the budget legislation. This arrangement is no more enforceable than transfer of resources to a public entity that receives funding for its operations generally.

We question the drafting of paragraph 92, particularly the reference “…i.e. there must be a binding arrangement that imposes present obligations on the transfer recipient”. We are unsure why the reference is to present obligations of the transfer recipient.

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 do not support the proposed difference in accounting.

We do not support the proposed difference in accounting between revenue and expenses without performance obligations. There are two key issues we have observed in the “mirroring” of these revenue and expense transactions.

Issue #1 – Consistency between transactions without performance obligations in ED 71 and ED 72

In reading the current text in ED 72, it is unclear whether the intention is for the requirements for when “present” obligations exist to be the same in ED 71 and ED 72.

We note that in ED 71, it is clear that for a present obligation to exist, the recipient must be required to undertake a specified activity or incur eligible expenditure.

In ED 72, we note the following:

Paragraph 9 in the definitions section indicates the following:

> *The following terms are defined in [draft] IPSAS [X] (ED 71), Revenue without Performance Obligations, and are used in this [draft] Standard with the same meaning as in [draft] IPSAS X (ED 71):*
>
> *(f) Capital Transfer;*
>
> *(g) Eligible expenditure;*
>
> *(h) Specified activity.*

We note that the terms “eligible expenditure” and/or “specified activity” are seldom mentioned in ED 72. Paragraphs IE169, IE 172, IE 176 mention eligible expenditure and paragraphs 105 and AG106 mention specified activity (or enforceable activity). These terms are not included in the discussion on the binding arrangement or recognition criteria for transfers without performance obligations. In particular, paragraph 92 states the following:

> *For a present obligation to exist, the transfer recipient must be able to enforce the transfer of resources by the transfer provider, i.e., there must be a binding arrangement that imposes present obligations on the transfer recipient. For a binding arrangement to exist, the following conditions must be 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 <u>obligations</u> to be performed; and*
>
> *(c) The transfer provider can identify the payment terms for the contribution to be transferred.*

It is unclear what is meant by “obligations” included in paragraph (b).

It is unclear what actions are expected from the other party, nor is it clear whether the nature of the transactions and/or requirements for transfer expenses without performance obligations and revenue without performance obligations – but with “present” obligations - are meant to be the same.

If the intention is that the nature of the transactions with present obligations in ED 71 and ED 72 to be the same, the text of ED 72 will need to be reviewed and significantly revised to better align the principles.

Issue #2 – Do not agree with the proposed accounting outcome in ED 71

The question in the specific matter for comment implies that there is a lack of symmetry and we have therefore assumed that the transactions in ED 71 and ED 72 are meant to be the same, i.e. they should both require the undertaking of specific activities or incurring eligible expenditure.

We do not believe that incurring eligible expenditure or undertaking specific activities on their own gives rise to a present obligation (see our response to specific matter for comment 1 in ED 71). As a result, we are of the view that ED 71 should be amended.

This would mean that revenue and expenses would be recognised consistently. We are of the view that if the substance, and terms and conditions of the transactions are the same, the accounting should be consistent for revenue and expense transactions.

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 support for proposal, there are however potential issues that need to be addressed.

In South Africa, there is no legal obligation to transfer resources until the appropriation is authorised. "Authorised" means approved by Parliament, Provincial Legislature or Municipal Council.

There has been little debate to date about when obligations arise, or rights exist for the transfer or receipt of resources. As a result, this is not a significant issue locally.

In terms of the guidance provided in ED 72, we note the following:

1. Transfers with performance obligations could also be subject to appropriations. We therefore question why this guidance is only provided for transfers without performance obligations.

2. We question the appropriateness of paragraph 150 which indicates that an entity should consider whether disclosure of a contingent liability is appropriate. Paragraph 150 states the following:

   > *Where a transfer provider has agreed to provide a transfer of resources subject to appropriations being authorized, and has not recognized a liability or expense as the appropriation has not yet been authorized, the transfer provider shall consider whether to disclose a contingent liability by applying the requirements of IPSAS 19.*

   Governments frequently commit - through their budgets and spending plans - to provide resources over the medium term to recipients. These future commitments are subject to appropriations. Arguably these would meet the requirements in paragraph 150 as the transfer provider has agreed to provide resources to another entity.

   Information about future commitments to transfer resources is usually comprehensively explained in budgets and other documents. We do not believe it is appropriate for these future commitments to be disclosed as contingent liabilities.

   As a result, we are of the view that either paragraph 150 should be deleted or amended to explain exactly in what circumstances or situations disclosure of a contingent liability may be appropriate.

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 do not support the mirroring of the presentation and disclosure requirements.

As a general observation, we do not believe that the distinction between transactions with or without performance obligations is helpful to users of the financial statements. As government and public sector entities do not plan and execute transactions in this way, the disclosure of information on this basis will be of little value. We also note that this classification of transactions, particularly from an expense perspective, is not consistent to or compatible with existing presentation and disclosure requirements.

Issue #1 - Presentation requirements for transactions with performance obligations

<u>Presentation of expenses in the statement of financial performance</u>

Paragraph 131 requires the following:

A transfer provider shall disclose all of the following amounts for the reporting period, unless those amounts are presented in the statement of financial performance separately from its other expenses:

(a) Expenses recognized from binding arrangements for transfer expenses with performance obligations by major classes;

(b) Expenses recognized from binding arrangements for transfer expenses without performance obligations by major classes; and

(c) Expenses recognized from transfer expenses without binding arrangements by major classes.

We are uncertain whether the presentation of expenses on the statement of financial performance based on whether they have performance obligations (or not), or binding arrangements (or not), is consistent with the requirements to classify expenses by nature or function in IPSAS 1 on *Presentation of Financial Statements*. We therefore suggest that the reference to the “statement of financial performance” in paragraph 131 be deleted.

We question whether the presentation of this information, along with the further disaggregation required in paragraphs 133 and 134 is helpful to users of the financial statements.

<u>Binding arrangement assets and liabilities</u>

As noted in our response to specific matter for comment 4, we agree that a binding arrangement asset should be recognised for instances when the transfer provider performs in advance of the transfer recipient fulfilling its performance obligations. In general accounting terms, this is considered an advance payment or equivalent.

We note that paragraph 123 indicates the following:

> *If a transfer recipient performs by transferring goods or services to a third-party beneficiary before the transfer provider pays consideration <u>or before payment is due</u>, the transfer provider shall present the binding arrangement as a transfer provider's binding arrangement liability, excluding any amounts presented as a payable. A transfer provider's binding arrangement liability is a transfer provider's obligation to pay consideration in exchange for goods or services that the transfer recipient has transferred to a third-party beneficiary.*

This paragraph effectively requires entities to separate their liabilities where performance has occurred, but payment is not due from those where there is an unconditional obligation to make a payment.

Stakeholders noted that this is overly complex and adds little value to users. They indicated that where goods, services or assets are acquired in exchange transactions this distinction is not required.

If the PSPOA is retained, we suggest that the requirements for binding arrangement liabilities be deleted. Entities should be required to present payables, based on when entities believe they have an unconditional obligation to transfer resources.

The requirements related to "binding arrangement assets" should be retained and redrafted to make it clear that these are advance payments where settlement of the asset is expected through the transfer of goods or services to 3rd party beneficiaries.

Disclosure requirements for transactions with performance obligations

<u>Payable balances</u>

We note that if an entity acquires goods, services or assets directly from a service provider (transfer recipient) for itself rather than for 3rd party beneficiaries, there is no separate disclosure of payables balances, nor a reconciliation of the opening and closing balances.

To specifically require this level of detail for 3rd party transactions is inappropriate. The "balance" of these disclosures versus disclosures for the "normal" acquisition of goods, services and assets will be unnecessarily skewed. The requirements should be deleted, or curtailed by, for example, having a single disclosure for payables relating to transfer expenses.

Stakeholders also noted that this level of detail would be difficult to produce if an entity has a large volume of binding arrangements at an entity.

<u>Allocation of consideration to remaining performance obligations</u>

Stakeholders did not support the disclosure of the allocation of the transaction consideration to the remaining performance obligations. Again, the view was that this information is overly detailed and will not add value to the users of the financial statements.

It is therefore suggested that these requirements be removed (paragraphs 139 to 141).

Issue #2 – Presentation and disclosure requirements for transactions without performance obligations

<u>Payable balances</u>

The same comment on payable balances applies to transactions without performance obligations. We also note that there seems to be a duplication between the requirements of paragraph 146(a) and 149. The requirements should be streamlined to ensure that information is not provided twice by entities in the financial statements.

Please refer to our response to specific matter for comment 8 on appropriations.

ANNEXURE B – OTHER SIGNIFICANT ISSUES

Issue #1 - Classification of expense transactions

Individual goods and services versus transfer expenses

Transfer expenses include the transfer of goods and services to individuals. Individual services in IPSAS 19 are defined as goods and services provided to individuals and/or households by a public sector entity that are intended to address the needs of society as a whole. Given that the transactions have similarities, it is difficult to distinguish when transactions would be in IPSAS 19 or ED 72.

Stakeholders locally indicated that the principles/descriptions used are not common accounting concepts (e.g. reference to “society as a whole”). A high degree of judgement will need to be applied to determine the classification. They also observed that because this seems to be based on the statistical classification rather than accounting concepts, they would likely need to engage a specialist to assist with the classification. We do not believe that this level of complexity is necessary for these transactions.

From an accounting perspective, we also do not understand why it is necessary to distinguish between transactions that are provided as part of an ongoing programme of government and those that are provided on an ad-hoc basis, particularly if the substance is the same. For example, entities may provide food parcels to citizens. Some do so as part of their ongoing activities (e.g. Department of Social Development and Welfare) while others provide food parcels on an ad hoc basis (e.g. a Municipality provides food parcels as part of “emergency relief”).

We do not see why the accounting should differ depending on whether this is being done as part of an ongoing programme of government (i.e. IPSAS 19) or on an ad-hoc basis (i.e. ED 72). This overly complicates the classification and has little impact for users of the financial statements. We note that while there might be similarities in the accounting outcome, the presentation and disclosure requirements are different.

We suggest that the classification requirements in IPSAS 19 and ED 72 should be reviewed, and the accounting consequences of the transactions reconsidered to ensure that they will result in relevant information to users.

If the requirements are retained, it would be useful to explain the key distinguishing factors between the transactions in IPSAS 19 and those in ED 72. This guidance could be issued by the IPSASB in the relevant Standards, or the staff could provide guidance in a staff FAQ.

To assist users of IPSAS with the classification, a Flowchart or a decision tree that outlines the key assessments that need to be made and which Standard should be applied might be helpful. We also note that this might make the “residual” category clearer (see our response to specific matter for comment 1).

“Re-imbursements” of expenses and whether they meet the definition of a transfer expense

Stakeholders raised questions with us about the classification of certain transactions that involve reimbursing a 3rd party for expenditure incurred for a beneficiary. These entities pay compensation to claimants for injuries incurred at work while on duty or injuries that resulted for traffic accidents. The compensation either takes the form of a cash annuity paid to the claimant (which is a social benefit) and/or it could include the payment of medical expenses or legal fees on behalf of the claimant. In some instances, the entity will contract directly with the medical or legal service provider to provide specified services to the claimant. In other instances, the claimant will contract directly with the medical or legal service provider and request the entity (transfer provider) to reimburse them for the expenditure incurred.

It is unclear whether these reimbursements meet the definition of a transfer expense. In substance the transaction is similar, except that the transaction is initiated by the 3rd party beneficiary with the transfer recipient rather than the transfer provider initiating the transaction with the transfer recipient. Guidance on these transactions would be helpful.

The stakeholders that questioned the classification of these transactions also noted potential issues with the measurement of these transactions using the PSPOA. As the extent of the injury may require complex medical and legal interventions, it may be difficult to estimate the consideration at the outset of the transaction as more information about the extent of the services needed may only be known at a later date. While this is variable consideration, it would require complex estimates and calculations to be made on an ongoing basis.

Issue #2 – Binding arrangement

A binding arrangement is defined as an arrangement that confers both enforceable rights and obligations on both parties to the arrangement. Paragraph AG9 indicates that an arrangement is enforceable when the transfer provider and the transfer recipient are both able to enforce their respective rights and obligations through legal or equivalent means.

From an expense perspective, we have observed the following regarding binding arrangements:

- Category 1 - A transaction where a transfer provider agrees to provide resources to a transfer recipient and have distinct goods or services provided to a 3rd party beneficiary is considered to be a "binding arrangement".
- Category 2 - A transaction where a transfer provider agrees to provide resources to a transfer recipient and the transfer recipient agrees to undertake some action or activity is considered to be a "binding arrangement".
- Category 3 - A transaction where a transfer provider agrees to provide resources to a transfer recipient without any action required by the transfer recipient is not considered a "binding arrangement". This is based on paragraph 92 which indicates that "For a present obligation to exist, the transfer recipient must be able to enforce the transfer of resources by the transfer provider, i.e. there must be a binding arrangement that imposes present obligations on the transfer recipient".

For the category 3 transactions, paragraph 93 indicates that "Transfers to be made outside of a binding arrangement are not enforceable by the transfer recipient, and no expense is recognized prior to the transfer provider transferring the resources".

We have noted in our response to specific matter for comment 6 that we do not agree that the category 3 transactions should effectively be recognised on the "cash basis" (accepting that non-cash consideration could be provided). We do not believe that an obligation does not exist simply because there are no present obligations imposed on the transfer recipient. For many "non-exchange" transactions, there will be no performance by the other party. A legal obligation might exist for the transfer provider – through budget legislation, contract etc. - to transfer the resources to a transfer recipient, irrespective of whether the transfer recipient is required to do anything.

Stakeholders locally observed that the category 2 and 3 transactions are both likely to be outlined in budget legislation/legal appropriations. They did not believe that the category 2 transactions were any more enforceable than the category 3 transactions.

The discussions in ED 72 about what is a binding arrangement and when present obligations arise raises concerns about whether the definition of a binding arrangement is appropriate.

It seems as if two ideas have been conflated, i.e.:

- how an arrangement arises, is governed, or enforced, e.g. contract, legislation or similar; and
- the characteristics of an arrangement, e.g. the rights and obligations in arrangements. In particular, we are of the view that whether there are rights and obligations for both parties, or one party has rights and the other an obligation is reflective of the characteristics of the transaction.

Combining these two ideas in the definition of a binding arrangement and using the existence or not of a binding arrangement to propose accounting has resulted in ultimate accounting outcomes which are not appropriate in all instances (see our response specific matter for comment 6 for examples).

As a result, we believe that the definition of a binding arrangement should focus only on how binding arrangements arise. The reference to both parties having both rights and obligations should be deleted.

Issue #3 - Subsequent measurement of non-contractual payables

There are requirements for the subsequent measurement of payables in the section on transfers without performance obligations. The guidance directs entities to IPSAS 41 on *Financial Instruments* for contractual payables and provides guidance for non-contractual payables. As ED 72 deals with expense transactions, we do not believe this guidance should be included in the proposed IPSAS.

It is also unclear why this guidance is only provided for transfers without performance obligations.

As a result of our comments above, we do not support the principles in paragraph 4. We do not believe that an expense Standard should be used to outline measurement principles for transactions that are not in the scope of the Standard. It is (a) unlikely that entities will apply the initial recognition and measurement principles of another Standard and then not know how to deal with subsequent measurement, and (b) users of the standards are unlikely to know that they should use the IPSAS on transfer expenses to deal with the subsequent measurement of non-contractual payables.

We believe that paragraph 4, along with paragraph 120 should be deleted.

ANNEXURE C – DRAFTING AND OTHER COMMENTS

Paragraph	Comment
1	Much of the accounting in ED 72 involves the recognition of assets and liabilities. Consider adding "assets and liabilities" in the paragraph as it is also important to understand the nature, amount, timing and uncertainty related to the assets and liabilities related to transfer expenses.
3	The paragraph (and paragraph 9) refers to "capital transfers". As there is no specific guidance on capital transfers, we do not see the need for these transactions to be mentioned in ED 72.
18	The 2nd sentence refers to the "ability" of the transfer recipient to provide the goods or services. As the ability of the transfer recipient to fulfil the requirements of the arrangement is not a criterion in paragraph 13, it is unclear if this example is correct.
94	This paragraph (which is also included for transactions with performance obligations) indicates that transfer expenses without performance obligations do not exist if either party can unilaterally terminate a wholly unperformed arrangement without compensating the other party. We are unsure of the relevance of this to the types of transactions that are transactions without performance obligations. Typically, these transfers are outlined in budget legislation or appropriations. We do not believe it is relevant, or appropriate, that the accounting is based on whether entities are required to pay consideration for exiting these arrangements. It is highly unlikely that these transactions would ever require consideration to be paid if the transaction is cancelled.
98 and 99	Guidance is provided on transfers subject to appropriations. We question why this is only included in the section on transfers without performance obligations. Transfers with performance obligations could also be subject to appropriations.
100 to 101	The requirements to identify modifications makes the accounting for transactions overly onerous. We note that the types of transactions envisaged as "without performance obligations" are generally intergovernmental or inter-entity transfers. As a result, we do not understand why this level of complexity is needed. See our comments on the response to the appropriateness of the PSPOA.
103 to 106	Given the nature of the transactions in question, we question whether this level of complexity is needed for measuring transactions.
124	The paragraph indicates that "payables" should be accounted for in IPSAS 41. As transfers with performance obligations can arise from contracts, legislation or similar, payables may arise from different mechanisms. We question whether the reference to IPSAS 41 is appropriate in all instances.

146	This paragraph includes disclosure requirements for specified activities. It is unclear why the requirements only relate to specified activities and not eligible expenditure if the intention is that present obligations could arise from both specified activities and eligible expenditure.
154	The transitional provisions indicate that if an entity early adopts the IPSAS, then it should also early adopt ED 70 and ED 71. We do not understand why the adoption of an expense Standard would/should be affected by the adoption of revenue standards. We also note that some revenue transactions (e.g. those in ED 70) may not be material for typical public sector entities involved in paying transfers to other entities. As a result, entities should be allowed to early adopt ED 72 independently of ED 70 and ED 71.
AG15	We note that the paragraph refers to the ability of both parties to enforce the rights and obligations of the arrangement. It then goes on to explain that the entity receiving the consideration must be able to enforce the promise to receive the funding, and the entity providing the funding must be able to enforce the fulfilment of the obligations assumed by the transfer recipient. This explanation only deals with the enforcement of the obligations – it does not deal with the enforcement of the *rights* by the transfer provider and transfer recipient. For the explanation to be comprehensive, it should deal with the enforcement of both rights and obligations for both parties. The same comment is applicable to paragraph AG17.
AG52	This paragraph merely explains the disadvantages of output methods. It does not seem to add value to readers. Either consider moving to the Basis for Conclusions or deleting the paragraph.
Appendix B	Changes to IPSAS 1 We note that the consequential amendments to IPSAS 1 do not include a separate line item for payables from transfer expenses. Paragraph 121 indicates that binding arrangement assets and liabilities should be presented on the statement of financial position. The last sentence says that payables should be presented separately from binding arrangement liabilities. We do not see this separate presentation for payables in the amendments to IPSAS 1.
	Changes to IPSAS 11 A change to paragraph 11 indicates that “Inventories also include (a) materials and supplies awaiting use in the production process, and (b) goods purchased or produced by an entity, which are for distribution to other parties for no charge (transfer expense) or for a nominal charge, for example, educational books produced by a health authority for donation to schools”.

	Would the distribution of these books always be considered a transfer expense? Could they also be individual services in the scope of IPSAS 19? The same comment applies to the amendments to paragraph 44.
Basis for Conclusions	Paragraph BC69 indicates that “the IPSASB considered that not all the information that was needed to assess the performance of a transfer recipient was necessary in assessing the performance of a transfer provider. For this reason, the IPSASB agreed not to include disclosure requirements for the disaggregation of expenses and the detailed information on binding arrangement balances”. We note that the requirements to disaggregate transfer expenses as well as provide information on binding arrangement balances is included in ED 72. We are not sure if BC69 and the presentation and disclosure requirements in ED 72 are consistent.
Implementation Guidance	The flow chart reflects that if there are no performance obligations, then the entity recognises expenses at the earlier of when a present obligation exists or when the resources are transferred. This is not consistent with paragraph 93 that indicates that where there is no binding arrangement, no expense is recognised prior to transferring the resources. As noted in our comments, we do not support this accounting, but if it is retained, then the flow chart will need to be updated to explain a further step, i.e. whether a binding arrangement exists for transactions without performance obligations.
	<u>Example 4</u> As the main text of ED 72 does not clearly articulate when a present obligation exists, it is difficult to understand the outcome of the various scenarios in example 4.
	<u>Example 23</u> We note that the total in the table between paragraph IE134 and IE135 does not cast. Based on the numbers in the list (40+60+30) it seems as if the amount should be CU130 and not CU120.
	<u>Examples 31 and examples 32</u> We note that these examples refer to “enforceable activity” and “eligible expenditure”. We note that these terms are not used in the main text or application guidance of ED 72.