

Task force IRSPM A&A SIG, CIGAR Network, EGPA PSG XII

Comments and suggestions considering the IPSASB document for ED 71 'Revenue without performance obligations'

The IPSASB has requested comments and answers to specific questions regarding its Exposure Draft (ED) 71, *Revenue without performance Obligations*. The comments and responses prepared by the Task Force IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are presented below.

The IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are three research networks that focus on Public Sector Accounting. The Task Force is made up of 17 researchers from these networks. The views expressed in this document are widely shared by the members of the Task Force, but neither do they represent the views of the whole research community represented by the networks, nor of the Institutions/Universities with which they are affiliated.

Core assumptions

We recognize the pivotal role of the IPSASB in developing high quality international public sector accounting standards to support financial reporting and to enhance non-financial disclosures by public sector entities to increase citizens' trust. We regard the development of standards and guidance on matters that are specific to the public sector as being a particularly important part of the continuing programme of work of the IPSASB. ED 71 contains proposals for a new revenue standard that would supersede IPSAS 23 *Revenue from Non Exchange Transactions*.

We are of the opinion that when public sector transactions resemble those taking place in the private sector, principles and standards may be kept as aligned as possible. However, for public-sector-specific transactions, as is the case for transactions relating to *Revenue without Performance Obligations*, we are in favor of standards that are not adapted artificially from private sector accounting and we think that there is a need to seek options that best fit the public sector. This core thesis underpins our proposals and recommendations herein.

We are pleased to respond to ED 70, 71 and 72, and we take the opportunity to congratulate the IPSASB on this achievement. With these three EDs, the IPSASB has moved away from the distinction between non-exchange and exchange transactions and instead embraced revenue with (ED 70) or without (ED 71) performance obligations. ED 72 provides for the recognition and measurement of transfer expenses. In this response, we first provide some comments that relate to ED 70, 71 and 72 combined. Subsequently, we offer our views on the specific requests for comments posed by ED71.

Comments relating to ED 70, 71 and 72 combined

1. Format of the consultation

We found the questions (SMCs) to be narrow in scope, thus limiting the type of responses that we could provide. Even the layout of the consultation paper is not very helpful as the questions are grouped and presented at the beginning of the document, rather than being integrated within the consultation paper as was done previously (for example, in the Measurement consultation).

In our opinion, the EDs are too long and dishearten prospective respondents to participate. We understand that the topic being dealt with by these EDs is complicated, but we suggest that future EDs are more focused and concise.

2. Overall structure of the three EDs and the analysis of the underlying subject

Contracts or other binding arrangements can contain transactions that are with performance obligations or without performance obligations. These two streams of transactions thus need to be dealt with under separate standards.

While we agree on the distinction between transactions with and without performance obligations, we think that the three EDs provide a scattered picture about the accounting treatment of transactions. For example, (a) the recipient of revenue with a performance obligation looks at ED 70, while the provider of this revenue looks at ED 72; (b) the recipient of a grant with a present obligation or a binding arrangement looks at ED 71, while the provider looks at ED 72. This dispersed referencing may cause confusion to the user, which is not justified by the IPSASB's statement that "ED 70 should only deal with revenue so that it is in line with IFRS 15" (BC 8).

Furthermore, the respective treatment of a transaction by the two parties is not directly evident in the same standard. Compare with, for example, Leases, where the accounting by the lessee and lessor are tackled in one document. The same should be done here, for example:

- Standard 1: '*Transactions with performance obligations*' to include (a) the recipient of the income, i.e. the seller (currently, ED 70) and (b) the provider, i.e. the purchaser (currently, ED 72).
- Standard 2: '*Transactions with present (non-performance) obligations*' to include (a) the recipient of the resources, i.e. the transferee (currently, ED 71) and (b) the provider, i.e. the transferor (currently, ED 72).
- Standard 3: '*Transfers without obligations*', to include (a) the recipient of the resources, i.e. the transferee (currently, ED 71) and (b) the provider, i.e. the transferor (currently, ED 72).

The respective treatments by the two parties need not 'mirror' each other, that is, the respective treatments could be totally different; but at least the standard would treat a transaction holistically – from both perspectives.

Besides having a critical stance on the fact that expenses are handled in a separate ED, we also see the need for more clarity and guidance about the linkages between the three EDs, even with regards to terminology, perhaps through the compilation of **a joint glossary**. A joint glossary may ensure transparency on the important definitions and terms not only across the three EDs but in general across all the standards issued by the IPSASB. For example, in the three EDs, the IPSASB refers to definitions used in other standards. It would be easier for users of standards having a joint glossary rather than referring to different files.

May we also point out that the style of writing and the type of language used decrease understandability. We appreciate the technicality of the subject, and also that standards are targeted for practitioners. However, even accountancy professionals and academics find the standards difficult to understand. Practitioners in public sector accounting would encounter a similar difficulty, detracting from the

attractiveness of IPSAS.

3. Need to evaluate the challenges of applying ED70, 71 and 72 in practice

Since the changes introduced by the three EDs are wide-spanning, we recommend that the IPSASB should monitor the issues that will emerge from the practical application of these standards. Since pilot studies are not feasible in a public sector context, this monitoring should be undertaken with public sector entities that will be actually applying ED70, 71 and 72. The monitoring could be in the form of a survey, for example, in 2-3 years' time, that would capture and document the effects and practical experiences of applying the three EDs. This exercise would reveal challenges associated with applying the standards in practice and would support the strengthening of the application guidelines. It may also assist in future revision of the standards.

ED71 Specific Matters for Comment

Specific Matter for Comment 1 (paragraphs 14-21)

The ED proposes that a present obligation is a binding obligation (legally or by equivalent means), which an entity has little or no realistic alternative to avoid and which results in an outflow of resources. The IPSASB decided that to help ascertain whether a transfer recipient has a present obligation, consideration is given to whether the transfer recipient has an obligation to perform a specified activity or incur eligible expenditure.

Do you agree with the IPSASB's proposals that for the purposes of this [draft] Standard, *Revenue without Performance Obligations*, a specified activity and eligible expenditure give rise to present obligations? Are there other examples of present obligations that would be useful to include in the [draft] Standard?

Response:

We agree with the proposal of considering a specified activity and eligible expenditure as a criterion to identify a present obligation.

We think that judgment is required to assess if a binding obligation does exist, unless of course the binding obligation has a legal form. In the public sector, it is normal practice for binding obligations to have a legal foundation. Please see also our comment in SMC 2 re-substance over form.

Finally, please note that the Conceptual Framework (5.18) defines a binding obligation by referring to both exchange and non-exchange transactions, while ED 71 (and ED 70) is not based on this kind of distinction. Therefore, the Conceptual Framework should be modified accordingly.

Specific Matter for Comment 2 (paragraph 31)

The flowchart that follows paragraph 31 of this [draft] Standard illustrates the process a transfer recipient undertakes to determine whether revenue arises and, if so, the relevant paragraphs to apply for such revenue recognition. Do you agree that the flowchart clearly illustrates the process? If not, what clarification is necessary?

Response:

The flowchart clearly illustrates the process a transfer recipient undertakes to determine whether revenue arises.

However, we think that the flowchart should explicitly mention “taxes”, as they “are the major sources of revenue for many governments and other public sector entities” (paragraph 27). The ED is based on a qualitative distinction between revenue with or without present obligation, which is crucial to define the scope of the ED; as a result, taxes are treated as a residual category, despite their importance. A qualitative distinction between taxes and other revenue—with or without present obligations—may be introduced.

A delicate point regards the “substance” vs the “form” of a binding arrangement. It should be taken into account that the “substance over form” principle may be not acceptable in certain administrative regimes, where the (legal) form would be indisputable.

A similar issue regards the “Contribution from owners” (mentioned in the flow chart):

- On the one hand, paragraph 7 states that: “In determining whether a transaction satisfies the definition of a contribution from owners, the substance rather than the form of the transaction is considered”.
- On the other hand, paragraph 8 refers to the existence of a formal designation or formal agreement.

This sounds quite contradictory, as referring to a formal arrangement would mean that the legal form of the transaction rather than the substance has to be considered.

Therefore, to identify “contribution from owners”, we would suggest first referring to a formal designation or a formal agreement; and, as a second step (if needed or if possible), evoking the substance of the transaction.

Specific Matter for Comment 3 (paragraphs 57-58)

The IPSASB decided that a transfer recipient recognizes revenue without performance obligations but with present obligations when (or as) the transfer recipient satisfies the present obligation.

Do you agree that sufficient guidance exists in this [draft] Standard to determine when a present obligation is satisfied and when revenue should be recognized? For example, point in time or over time. If not, what further guidance is necessary to enhance clarity of the principle?

Response:

We agree with the proposed approach, which is consistent with the approach taken in the ED to provide broad principles.

As for the measurement of revenue, the requirements for variable inflows described in paragraph 67 involve a lot of guesswork. Even the disclosure of the underlying assumptions may not compensate for the high degree of subjectivity and uncertainty that is present in these calculations. The alternative could be to place greater emphasis on conservatism, recognizing variable inflows only when they became certain (in terms of time and value; see BC16, page 81).

Furthermore, the identification and reporting of a significant financing component in the binding arrangement (par. 72-77), even if this may be true, may not be acceptable/proper for a public sector entity. Actually, this is a general issue and, in practice, it could be difficult to identify the financing component, which could mean disclosing that a premium price would be paid. For example, government entities that circumvent borrowing constraints by purchasing goods and services at a premium in exchange for longer payment terms. Or from the other perspective, a government entity that provides a service at a reduced price or by providing substantial credit terms, may be doing so in order to provide some form of social assistance; therefore, it would be difficult to explain why the government entity is recognising and reporting a financing component relating to the transaction.

Specific Matter for Comment 4: (Paragraphs 80-81)

The IPSASB decided that the objective when allocating the transaction price is for a transfer recipient to allocate the transaction price to each present obligation in the arrangement so that it depicts the amount to which the transfer recipient expects to be entitled in satisfying the present obligation. The amount of revenue recognized is a proportionate amount of the resource inflow recognized as an asset, based on the estimated percentage of the total enforceable obligations satisfied.

Do you agree sufficient guidance exists in this [draft] Standard to identify and determine how to allocate the transaction price between different present obligations? If not, what further guidance is necessary to enhance clarity of the principle?

Response:

In general, we agree. We would suggest adding *ad hoc* examples concerning the estimation of the percentage of the total enforceable obligations satisfied.

Specific Matter for Comment 5: (Paragraphs 84-85)

Do you agree with the IPSASB's proposals that receivables within the scope of this [draft] Standard should be subsequently measured in accordance with the requirements of IPSAS 41, *Financial Instruments*? If not, how do you propose receivables be accounted for?

Response:

Yes, we agree to measure receivables in accordance with the criteria defined by IPSAS 41.

We agree that credit risk is not considered when the amount the transfer recipient expects to receive is determined. Future impairment of a receivable is measured following the guidance of IPSAS 41 (see paragraph 61).

Specific Matter for Comment 6: (Paragraphs 126-154)

The disclosure requirements proposed by the IPSASB for revenue transactions without performance obligations are intended to provide users with information useful for decision making, and to demonstrate the accountability of the transfer recipient for the resources entrusted to it.

Do you agree the disclosure requirements in this [draft] Standard provide users with sufficient, reliable and relevant information about revenue transactions without performance obligations? In particular, (i) what disclosures are relevant; (ii) what disclosures are not relevant; and (iii) what other disclosures, if any, should be required?

Response:

We agree that the proposed disclosures provide users with relevant information.

We think that the most important disclosures concern the different categories of revenue (paragraph 131), namely: Taxes; Transfers with present obligation; Transfers without present obligation. Therefore, we would suggest classifying revenue on the face of the Statement of Financial Performance (eventually modifying IPSAS 1 accordingly). Disclosures in the notes could be presented following the main categories of revenue.

Furthermore, we would suggest providing illustrative *ad hoc* examples or guidance to guarantee more effective coordination with IPSAS 18, *Segment Reporting* (see paragraph 142).

We agree that accounting policies adopted for the recognition of revenue and the measurement criteria should be disclosed in the notes. For example, an interesting case is that of income tax revenue, whose recognition could be based on “statistical models” (Par. 98), which will result “in the actual amount of assets and revenue recognized being different from the amounts determined in subsequent reporting periods as being due from taxpayers in respect of the current reporting period” (Par. 99). Given the importance of income tax revenue and the potential unreliability of these statistical models, a possible additional disclosure could be for governments to disclose the size of the differences (i.e. estimation errors) mentioned in Par. 99 for the last years (for example 3 or 5 years).

As far as services-in-kind are concerned, paragraph 110 uses the word “may” (“A transfer recipient may, but is not required to, recognize services in-kind as revenue and as an asset”). As a general rule, we think that disclosure of services-in-kind in the Notes should be sufficient, and that the ED should not allow their recognition as revenue and assets. Perhaps, this recognition could be allowed only in the case when services-in-kind are used to construct an asset, and the services-in-kind are included in the cost of the asset (par. 112).

We tend to agree with Par. 133, which strongly encourages the disclosure of qualitative information on the nature and type of services in-kind received during the reporting period. Moreover, the disclosure could not necessarily be only qualitative (as referred in Par. 133); it could be quantitative but not in monetary units, for example hours worked, person months, etc.

Specific Matter for Comment 7: (Paragraphs N/A)

Although much of the material in this [draft] Standard has been taken from IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, the IPSASB decided that the ED should establish broad principles for the recognition of revenue from transactions without performance obligations, and provide guidance on the application of those principles to the major sources of revenue for governments and other public sector entities. The way in which these broad principles and guidance have been set out in the ED are consistent with that of [draft] IPSAS [X] (ED 72), *Transfer Expenses*.

Do you agree with the approach taken in the ED and that the structure and broad principles and guidance are logically set out? If not, what improvements can be made?

Response:

We agree with the decision to establish broad principles for the recognition of revenue from transactions without performance obligations. A previous consultation paper, namely “Accounting for Revenue and Non-Exchange expenses”, had suggested different classifications (Category A, B and C transactions, conditions, restrictions, and so on) which could generate confusion. Thus, building on broad principles should reduce this kind of risk, even though a risk of lowering comparability may arise. More generally, the accrual principle should be applied to the extent that the information has certain qualitative characteristics, including reliability and verifiability (Chapter 3 of the IPSASB Conceptual Framework).

Considering the structure of the proposed ED, taxes seem to be given less importance than transfers. The flowchart (see p. 14), for example, does not explicitly mention taxes. We believe that the proposed Standard should provide a more precise classification of revenue (for example, distinguishing taxes from other revenue, which in turn is articulated in revenue with or without present obligation).

Furthermore, there is not much difference between the requirements in the ED and IPSAS 23, *Non Exchange Transactions*. In fact, some of the issues in IPSAS 23 have not been resolved, especially in the case of tax revenue.

For example, the possible options concerning accounting for tax revenue that are allowed by paragraphs 89-106, have not decreased what IPSAS 23 permitted. Certain terms are better explained, for example, the taxable event and the variables to be considered by measurement models. These descriptions would be very helpful, for example, to explain the basis of preparation of budget figures (estimates). However, the subjectivity and uncertainty that exist in the proposals, undermine the reliability of the figures for tax revenue that would be reported in the Statement of Financial Performance, and as tax receivable in the Statement of Financial Position.

The “constraint requiring measurement of revenue and the associated receivable only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognized will not occur” (BC16, page 81) should be given more prominence in the standard itself in order to eliminate any doubts when there is uncertainty about collection (time and value). Therefore, the IPSASB should reconsider the alternative view that, in the case of tax revenue, due to the difficulties in measurement, “an entity only gains control over resources arising from taxation when those resources are received” (BC 30, page 84).

Other comments:

- Application of Principles and requirement to Specific Transfers
 - Capital transfers (par. 108-109) refer to capital grants (BC.19, page 82). This should be clearly stated in the standard.

BC 23 states that “The IPSASB agreed that this approach [IAS 20] did not provide useful or representationally faithful information for users”. This BC is not very convincing. We are in favour of IAS 20’s accounting treatment, which recognises capital transfers (grants) as revenue on a systematic basis over the useful life of the asset financed by the grants. We think that this approach is particularly suited for governments because, unlike private firms, capital grants are a common way of funding the purchase of non-current assets. The receipt of the capital grant and its accounting treatment should be disclosed in the notes.
- Appropriations (see example 31 and refer to ED 72)
 - According to our comments on ED 72 (SMC8), we think that when resources to be transferred are subject to the appropriation being authorized, the authorization has a substantive role, except for particular circumstances or under specific legal frameworks. As already underlined, we think that the legal form is generally indisputable, so the “substance over form” principle may be acceptable only in certain administrative regimes.
- Illustrative examples:
 - Example 30, IE73 (p. 102): “Using the same facts as **Example 27** above”; *to read* “Using the same facts as **Example 29** above”
 - Example 32, IE83 (p. 103): The facts are the same as in Case A of **Example 30**”; *to read* “The facts are the same as in Case A of **Example 31**”

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Signed on behalf of the persons listed below:

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