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EUROPEAN COMMISSION
BUDGET

The Accounting Officer of the Commission

Brussels
BUDG.DGA1/RAB

Subject: Comment letter on Exposure Draft 72 'Transfer Expenses'

Dear Mr Carruthers,

I welcome the opportunity to comment on the above mentioned Exposure Draft 72 'Transfer Expenses' ('ED'). The following comments are made in my capacity as the Accounting Officer of the European Commission, as the Accounting Officer of 22 other EU entities and on behalf of the Accounting Officers of 40 EU institutions, agencies and EU bodies (see list in Annex 1). I am responsible for, amongst other tasks, the preparation of the consolidated annual accounts of the European Union ('EU'), which comprise more than 50 European institutions, agencies and European bodies with an annual budget of more than EUR 140 billion, as well as the adoption of the accounting rules applicable by entities preparing annual accounts in the EU context (the 'EU Accounting Rules').[1]

According to the Financial Regulation applicable to the general budget of the Union, the EU Accounting Rules applied to prepare the EU consolidated annual accounts, as well as the separate annual accounts of the consolidated entities, should be based on internationally accepted accounting standards for the public sector, i.e. the IPSAS. The Financial Regulation allows for deviating from the IPSAS if the Accounting Officer considers it necessary, in order to give a fair presentation of the assets and liabilities, expenses, revenues and cash flow – an option of only theoretical importance so far.

I am pleased to provide you with my comments with the aim of improving the transparency, relevance and comparability of the financial statements across jurisdictions.

Serving the public is the primary objective of the public sector. Providing grants and other transfers to beneficiaries is by far the most significant item of expenditure for many public sector entities and in particular the EU institutions, agencies and bodies. As there is currently no specific guidance on how to account for these transactions, I very much appreciate the IPSASB's efforts to fill this significant gap.

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[1] For the sake of clarity, the views presented in this comment letter do not represent the views of the EU Member States, or the views of the European Public Sector Accounting Standards ('EPSAS') Team, and are without prejudice to future decisions which may be taken in the context of the EPSAS project.

Mr Ian Carruthers
Chairman
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Under the current EU Accounting Rules, grants and other transfers to beneficiaries paid out in advance are recognised as an asset (i.e. pre-financing asset amounting to approximately EUR 50 billion in the EU's consolidated balance sheet) and only recognised as an expense once the supported policy objectives have been implemented (activity performed, goods transferred etc.). This achievement of objectives is evidenced and verified by EU services by the submission of implementation reports, cost statements (eligible costs incurred) and invoices. The amount of open pre-financing to be recognised in the EU's annual accounts is poised to increase dramatically under the upcoming recovery instrument Next Generation EU, which foresees a total support of up to EUR 750 billion and which will affect the financial statements of our Member States.

This accounting treatment is based on the understanding that the legal framework governing the EU's operational activities, together with the rights and obligations established by the specific programme agreements. These agreements, which include clearly defined objectives, monitoring and reporting requirements, subsequent audits as well as the right to recover funds in case of irregularities, ensure that the EU retains control until the transferred funds are spent in line with the EU's policy objectives. **The EU had applied this approach since the introduction of full accrual accounting in 2005. It has been established, in the absence of an IPSAS standard, following extensive discussions with the EU Advisory Group of Experts on Accounting Standards, a body consisting of public sector accounting experts and set up with the specific objective of advising in the process of establishing new accounting rules. This approach has also been accepted by the EU's auditors ever since its introduction.**

I am convinced that measuring transfer expenses in line with this approach and based on a well-established control environment of pre-financing amounts spent, which are meticulously monitored, is not only appropriate from an accounting point of view, but also in terms of accountability. It rightfully reflects our ultimate responsibility as a public sector entity for managing and supervising our operational activities in line with the principles of sound financial management. In fact the level of pre-financing and its development throughout the years is followed-up closely in the annual discharge procedure, and the European Parliament and the European Council as our main discharge authorities very much appreciate this approach and in particular the information to be found in the financial statements. It is seen to give a better control over the financing of the EU's policy objectives. It would politically be inconceivable that a potential loss of information in the financial statements presented to the budget authority arose as the result of a new accounting standard.

The ED emphasises the role of public sector entities as a provider of goods and services. This direct link to goods and services seems more prevalent in the private sector as well as in subordinate levels of government, where the existence and purpose of businesses is defined by the provision of such specific goods or services. However, it does not coincide with the typical operations of a supra-national organisation such as the EU, which achieves its objectives by a much wider range of activities. The EU typically does not to act merely as a purchaser of specific goods or services, but sets strategies and direction in order to benefit the public in a meaningful and efficient way. This is reflected in our binding arrangements, which often require an entity to implement particular actions or activities in order to achieve our policy objectives. I see those actions and activities as additional obligations in their own right. **It is against this background that I would like to express my concern that the current wording of the ED does perhaps not reflect this reality sufficiently**.

I believe that the decisive question when analysing the existence of an asset is to determine if the binding arrangement confers to the transfer provider the right to require the transfer recipient to carry out specified activities or incur eligible expenses in line with its policy objectives. If these requirements are fulfilled, I trust that the existence of an asset is sufficiently substantiated.

Based on this reasoning, and considering the outstanding importance of the area of transfer expenses for public sector entities, I believe that the ED could benefit from the inclusion of a **further category comprising binding arrangements with obligations (other than the currently defined performance obligations)** where the transfer provider retains control and thus holds an asset, so as to fully reflect the economic reality in the public sector. Alternatively, the present obligation category could be made clearer as regards cases where, under well-defined conditions, control over a resource is retained by a transfer provider. As the entire financial management system in the EU is designed to perform controls, in order to ascertain whether or not funds have been spent in accordance with Union law, this approach would also ensure that the accountability and control measures in place will continue to be applied, keeping the principle of sound financial management in the public sector intact.

I would also like to express a practical concern regarding the implementation of this ED. The current proposal in the ED (public sector performance obligation approach and present obligation approach) is a rather complex way of getting to a rather simple accounting outcome (i.e. recognition of expense at a point in time versus over time). The necessary contract-by-contract analysis, which would be unavoidable, would have a huge impact on our business processes and could require enormous resource commitment and significant system changes. This is because the EU typically enters into large-scale binding arrangements containing numerous individual obligations, with some fulfilling the definition of performance obligations and others the definition of present obligations. Applying the ED as it stands now would require an analysis of each binding arrangement and assigning these obligations to the categories included in the ED, something we do not consider practically feasible, or only at prohibitive cost. I therefore propose that the final Standard should **allow contracts to be analysed within groups of contracts at a high level, which would be accounted for using one accounting approach per one group**.

In this context, I would also like to highlight that in my view the business and accounting processes should pay significant attention to the operational requirements and economic reality. In my discussions with financial managers in the EU institutions and bodies it has become clear that for them, it was until now not important to differentiate between the delivery of goods and services or the implementation of specified activities/incurrence of eligible costs by the transfer recipient. Consequently, contracts contain a mixture of performance obligations and present obligations relevant for the policy objective. The implementation of policy objectives by the transfer recipient is thus clearly relevant and it is extremely difficult to convey the message that, as a result of a new accounting standard, business processes and contractual agreements need to be amended with no benefit or additional information gain for policy implementation.

Addressing the aforementioned concerns appropriately is of utmost importance to us, and would also mean that the final IPSAS on Transfer Expenses could be adopted as an EU Accounting Rule without further modification in this respect. I would like to emphasise that we have always acknowledged and publicly highlighted the benefits of IPSAS implementation, and we have always been very proud that the EU consolidated annual accounts, as well as the numerous individual accounts of the European institutions, agencies and other bodies applying the EU accounting rules, are fully compliant with the IPSAS. Up to now we consider that we have been fully in line with IPSAS and would like to continue with this. We believe that our proposals included in this comment letter would allow us to do so**.**

Finally, I would like to thank the IPSASB Staff for their preparation of and their availability during the workshops on transfer expenses, held in collaboration with the United Nations and the African Union.

Please find our detailed responses to the questions in the ED, as well as two examples illustrating our specific working environment as a supra-national institution, operating in a highly political context and under different management modes, in Annex 2.

If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

[e-signed]

Rosa ALDEA BUSQUETS

Enclosure: Annex 1: List of entities supporting comment letter
Annex 2: EU's response to the questions raised on the ED

c.c.: Thomas Müller-Marqués Berger, IPSASB Consultative Advisory Group
Nicole Smith, Director BUDG C,
Derek Dunphy, Martin Koehler, Lars Ruberg, BUDG C2,
John Verrinder, Head of Unit ESTAT C1

Annex 1 – List of entities supporting comment letter

Entities under the responsibility of the Accounting Officer of the European Commission

European Institutions
European External Action Service
European Data Protection Supervisor
European Agencies
Agency for the Cooperation of Energy Regulators (ACER)
European Union Agency for Law Enforcement Training (CEPOL)
Body of European Regulators for Electronic Communications (BEREC Office)
European Institute for Gender Equality (EIGE)
European Agency for Safety and Health at Work (EU-OSHA)
Consumers, Health, Agriculture and Food Executive Agency (CHAFEA)
European Global Navigation Satellite Systems Agency (GSA)
European Joint Undertakings
Bio-based Industries Joint Undertaking (BBI-JU)
Shift2Rail Joint Undertaking (Shift2Rail JU)
Fuel Cells and Hydrogen Joint Undertaking (FCH JU)
Single European Sky ATM Research Joint Undertaking (SESAR JU)
Innovative Medicines Initiative Joint Undertaking (IMI JU)
Electronic Components and Systems for European Leadership Joint Undertaking (ECSEL JU)
The European High Performance Computing Joint Undertaking (EuroHPC)
EU Trust Funds
EU Emergency Trust Fund for Africa (EUTF Africa)
EU Trust Fund Bêkou for the Central African Republic (EUTF Bêkou)
EU Trust Fund for Colombia (EUTF Colombia)
EU Regional Trust Fund in Response to the Syrian crisis (EUTF Madad)
Other entities
European Development Fund
European Institute of Innovation & Technology (EIT)

Annex 1 – List of entities supporting comment letter

Entities with independent Accounting Officers

European Institutions
European Council and Council of the European Union
European Parliament
European Court of Auditors
Court of Justice of the European Union
European Economic and Social Committee
Committee of the Regions
European Ombudsman
European Agencies
Education, Audiovisual and Culture Executive Agency (EACEA)
Research Executive Agency (REA)
Executive Agency for Small and Medium-sized Enterprises (EASME)
European Research Council Executive Agency (ERCEA)
Innovation and Networks Executive Agency (INEA)
European Maritime Safety Agency (EMSA)
European Medicines Agency (EMA)
European Chemicals Agency (ECHA)
European Environment Agency (EEA)
European Banking Authority (EBA)
European Asylum Support Office (EASO)
European Border and Coast Guard Agency (Frontex)
European Union Agency for Criminal Justice Cooperation (Eurojust)
European Centre for Disease Prevention and Control (ECDC)
European Centre for the Development of Vocational Training (CEDEFOP)
European Union Agency for Cybersecurity (ENISA)
European Food Safety Authority (EFSA)
European Union Agency for Railways (RAIL)
Community Plant Variety Office (CPVO)
European Fisheries Control Agency (EFCA)
European Union Intellectual Property Office (EUIPO)
European Union Aviation Safety Agency (EASA)
European Securities and Markets Authority (ESMA)

Annex 1 – List of entities supporting comment letter

Entities with independent Accounting Officers (continued)

European Training Foundation (ETF)
European Foundation for the Improvement of Living and Working Conditions (Eurofound)
European Monitoring Centre for Drugs and Drug Addiction (EMCDDA)
European Union Agency for Law Enforcement Cooperation (EUROPOL)
European Union Agency for Fundamental Rights (FRA)
European Insurance and Occupational Pensions Authority (EIOPA)
Translation Centre for the Bodies of the European Union
Fusion for Energy (European Joint Undertaking for ITER and the Development of Fusion Energy)
European Union Agency for the Operational Management of Large-Scale IT Systems in the Area of Freedom, Security and Justice (eu-LISA)
Other entities
European Coal and Steel Community in Liquidation (ECSC i.L.)

Annex 2 – EU's response to the questions raised on the ED

EXPOSURE DRAFT 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?

EU's response:

<u>*Scope of the [draft] Standard*</u>

We agree that the scope of the [draft] Standard is clear.

We fully acknowledge the reasons for the scoping of ED 72 as outlined in the BCs and in particular the objective to address the accounting for grants, contributions and other transfers (BC.8(c)) where an important gap in the IPSASB literature has been identified.

Although it follows from the definition of transfer expenses that normal purchase transactions do not fall into the scope of the draft Standard we consider it useful to have this clarification included in paragraph 3 of ED 72, as it emphasises that only a specific subset of the performance obligations within the scope of ED 70 'Revenue with Performance Obligations' is within the scope of ED 72.

We note that paragraph 3 of ED 72 also clarifies that transfer expenses incurred for capital transfers (i.e. outflows arising from a binding arrangement of cash or another asset with a specification that the transfer recipient acquires or constructs a non-financial asset that will be controlled by the transfer recipient) are within the scope of the standard. Considering that transfer expenses incurred for capital transfers are covered by the definition of transfer expenses (as opposed to a transaction which is not covered by the definition but intended to be treated as a transfer expense), we think this clarification should be moved to the section including the definition of transfer expenses.

Whereas paragraph 4 of ED 71 'Revenue without Performance Obligations' illustrates the practical scope of the draft Standard by enumerating the most typical transactions, ED 72 is silent in this respect. We would consider it useful to follow a similar approach in ED 72 and to include an enumeration of the most relevant transactions into the draft Standard. In our view, any such illustration should differentiate between common practical examples falling into the following categories:

(i) binding arrangements with performance obligations as currently defined in paragraph 9 of ED 72 (referencing to draft Standard ED 70),

(ii) binding arrangements with present obligations (as currently defined in paragraph 14 of draft Standard ED 71) where the transfer provider does not retain control,

(iii) binding arrangements with other obligations where the transfer provider retains control (see our reply to SMC2), and

(iv) no binding arrangements.

<u>Definition of 'transfer expenses'</u>

We agree with the definition of transfer expenses. However, we suggest the following clarifications:

We note that in our practical experience the most common asset a transfer provider provides to a transfer recipient are funds (cash) rather than goods or services. We therefore suggest to explicitly referring to this common fact pattern when clarifying the function of the 'other asset' element of the definition (as is already the case for non-current assets).

As regards footnote 3 to paragraph 8 we suggest to clarify if the references to 'goods and service' or 'goods or services' included in ED 72 should also be read as incorporating references to assets when the draft standard is addressing performance obligations (as the definition of performance obligations in paragraph 7 of ED 70 'Revenue with Performance Obligations' is not accompanied by an equivalent footnote).

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?

EU's response:

We do not agree with the proposed distinction.

It is generally advantageous to use harmonised distinction criteria for revenue and expense transactions as in many public sector transactions the transfer provider and recipient are public sector entities. However, we think an important sub-set of transfer expenses is not reflected in the proposed distinction. ***We believe the ED could benefit from the inclusion of a further category comprising binding arrangements with obligations (other than the currently defined performance obligations) where the transfer provider retains control and thus holds an asset so as to fully reflect the economic reality in the public sector.*** *Currently this third type of transactions is not explicitly addressed in the ED, which could lead to differences in interpretation. Alternatively, the present obligation category could be made clearer as regards cases where, under well-defined conditions, control over a resource is retained by a transfer provider.*

We are concerned that the proposed distinction may lead to an over-complication of what is in the end a simple accounting treatment (i.e. recognition of expense at a point in time versus recognition over time), as well as the introduction of criteria that are in our view, and after intensive internal consultations among financial managers, not of great relevance to financial managers and policy officers dealing *with grants and transfers in the EU institutions and bodies. As explained in the cover letter, differentiating between the delivery of goods and services or the implementation of specified activities/incurrence of eligible costs by the transfer recipient is not a very relevant factor in EU policy implementation, contract design, monitoring and business processes. What is important is rather that policy programmes have been implemented in line with the applicable law, the policy objectives and based on eligible costs. These are the driving factors on which financial management is based in the EU institutions and bodies in combination with strictest monitoring and control processes. It is also not in all cases important or relevant to pre-define the way of implementation, which one would need to know if one were to apply the proposed distinction. Based on this we have, in our internal consultations, received rather negative feedback and resistance on the necessity to potentially adjust business processes, contract design etc. based on accounting criteria that are not seen as very relevant for the operational management of grants and transfers.*

We also note that we supported the proposed distinction in our comment letter on the Consultation Paper 'Accounting on Revenue and Non-Exchange Expenses' with a broader understanding of 'performance obligation' in mind.

While we agree that binding arrangements with performance obligations are characterised by specific enough features to consider them as a separate category of transfer expenses, we do not think it is the distinction between binding arrangements with performance obligations and those without that should determine the accounting treatment of transfer expenses. This is because the decisive question from an accounting point of view is not the classification of a binding arrangement as a binding arrangement with or without performance obligations, but rather the question of whether the transfer provider, when transferring the agreed resources to the transfer recipient, retains an asset, or not. Although we certainly acknowledge that the answer to this question is influenced by the specific characteristics of the underlying binding arrangement, we are not convinced that the separating line between those binding arrangements in which an asset exists, and those in which not, is as clear-cut as suggested by ED 72.

According to ED 72 this separating line corresponds exactly to the proposed categories mirroring the distinction for revenue transactions proposed in ED 70 'Revenue with Performance Obligations' and ED 71 'Revenue without Performance Obligations'. Whereas in the case of binding arrangements with performance obligations ED 72 concludes that an asset exists, it generally denies the existence of an asset in the case of binding arrangements without performance obligations. We understand this general conclusion is based on the view that it would not be possible in all circumstances to identify a resource (BC52), and that even if it were possible to identify a resource (for example, where a binding arrangement requires a transfer recipient to construct an asset), that resource would never be controlled by the transfer provider (BC53). We note that the Basis for Conclusions also points out that the transfer provider's right to have the resources returned if the transfer recipient did not comply with its obligations in the binding arrangement, or had not spent the funds by the agreed date ('claw-back'), is not considered in the analysis, as it is contingent on the transfer recipient's future non-compliance with the binding arrangement (or future failure to fully utilise the funds) and thus supposed to be a resource beyond the transfer provider's control (BC54).

We consider that the arguments brought forward are not convincing. In our view the rationale applied to binding arrangements with performance obligations, which we fully support, is not equally applied to binding arrangements with present obligations other than performance obligations. This is because for binding arrangements with performance obligations the ED, when analysing the asset criteria, more specifically *the requirements for there being a resource and control, makes reference to the transfer provider's rights, whereas for binding arrangements with present obligations other than performance obligations it makes reference to the enforceable activities:*

- *Resource:*

  In the case of binding arrangements with performance obligations, the identified resource is the transfer provider's right to have goods or services transferred to a third-party recipient, and not the goods or services to be transferred themselves (BC28). In contrast, in the case of binding arrangements with present obligations other than performance obligations, the ED does not refer to the transfer provider's right to have specified activities carried out or eligible expenses incurred which are in line with its policy objectives, but to the actual activities themselves, e.g. the performing of research or the construction of an asset, which ultimately leads to the conclusion that it is doubtful whether a resource would be identifiable in all circumstances (BC52-53).

  In our view, in the same way as for binding arrangements with performance obligations, the actual point of reference should be the transfer provider's rights as foreseen in the underlying binding arrangement. These rights are identifiable even if the activities, e.g. incurring eligible expenses or carrying out specified activities, are not as concise as the transfer of a distinct good or service to a third-party recipient. In fact, a binding agreement with a public sector entity often requires the implementation of specific actions/activities in line with the public sector entity's objectives. Although those activities may not meet the narrow definition of 'goods or services', they are an important part of the reason for existence of the public entity and the implementation of its policy and objectives. Therefore, the existence of a resource could only be denied in the exceptional case where having the activities foreseen in the binding arrangement carried out or the eligible expenses incurred would not allow the transfer provider to meet its policy objectives.

- *Control:*

  In the case of binding arrangements with performance obligations, the indication of control is the transfer provider's enforceable right, as foreseen in the binding arrangement, to have a good or service transferred to a third-party recipient thus enabling him to meet its policy objectives (BC31). In other words what is required is control over the transfer, not control over the transferred goods or services themselves.

  In contrast, in the case of binding arrangements with present obligations other than performance obligations, the ED limits its analysis to the question if the transfer provider controls the underlying asset or activity (e.g. in cases where the transfer recipient is required to construct an asset such as a hospital or to perform specific research activities) and concludes that it does not (BC53).

  In our view, when applying the rationale for binding arrangements with performance obligations consistently to binding arrangements with present obligations other than performance obligations, i.e. when taking the rights as included in the binding arrangement as a reference point, it follows that the transfer provider can have the same degree of control over the carrying out of the activities in question as the transfer provider of a binding arrangement with performance obligations over the transfer of the good or service to the third-party recipient.

- *Past event (leading to present control over the resource):*

  We note that the requirement of a past event (leading to control over the resource) is equally fulfilled in the case of binding arrangements without performance obligations as in the case of binding arrangements with performance obligations (BC32). This is because both the right to have certain activities carried out or eligible expenses incurred and the control of that resource arise from the binding arrangement itself. Therefore, the past event is represented by the binding arrangement.

We therefore conclude that the definition of an asset can also be met in the case of binding arrangements with other obligations than performance obligations. This is especially the case when the binding arrangement contains both (i) legal safeguards as well as adequate monitoring, reporting and audit requirements which ensure that the transfer provider can require the transfer recipient to spend the transferred funds in line with the transfer provider's policy objectives, and (ii) the transfer provider's right to have the resources returned if the transfer recipient did not comply with its obligations in the binding arrangement, or had not spent the funds by the agreed date ('claw-back'). In such a setting (i.e. well-defined and designed system of monitoring and controls as well as a claw-back mechanism) the transfer of the resources gives the transfer provider the right to obtain future benefits, either in the form of service potential (as having the specified activity carried out or eligible expenses incurred meets the transfer provider's policy objectives), or in the form of economic benefits (by receiving a refund of the funds transferred).

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?

EU's response:

We agree with the proposal of the draft Standard that not monitoring the satisfaction of the performance obligations should be an indicator of lack of control, which would ultimately lead to a different accounting treatment.

We note that the same requirements should apply to the proposed third category relating to binding obligations without performance obligations where an asset is retained (see our reply to SMC 2). Please refer to the examples included in the last section of our comment letter for an illustration of a monitoring system fulfilling these requirements.

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?

EU's response:

We agree with this SMC. However, as noted in our reply to SMC 2, we believe that if one retains the proposed distinction (performance obligation versus present obligation) a similar accounting treatment is appropriate for present obligations where the transfer provider retains control. It is to be understood that the retention of control needs to be demonstrated by a complete and coherent system of managing, monitoring, controlling and safeguarding of resources transferred.

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.

EU's response:

We expect practical difficulties in the following areas of application:

1) Splitting the binding arrangement in components based on present and performance obligations.

A binding arrangement in the public sector can often contain numerous contractual obligations in the form of implementation of actions/activities or goods/services to third parties. This is in particular the situation in the EU grant agreements as until now the proposed distinction in transfer of goods and services versus incurrence of enforceable activities/eligible expenses has not been seen as a very relevant factor for financial managers and policy officers. In some cases, there could be a combination of present and performance obligations within one binding arrangement. Splitting a large number of agreements in two or more parts in practice could have a huge business impact as it could require enormous resource commitment and significant system changes. In the case of the European Union, there are thousands of open contracts at any point in time and analysing their content individually would be virtually impossible. ***We would therefore propose that the Standard would allow contracts to be analysed within groups of***

contracts at a high level, which would be accounted for using one accounting approach per one group.

2) Receiving timely information from the transfer recipient on the satisfaction of performance obligations by transfer to third parties.

Where the transfer provider monitors the transferred funds, the transfer recipient could provide the relevant information with regards to the satisfaction of the performance obligations with a certain time delay. This could be the case, for example, where a first detailed control is performed on the transfer recipient's side, who is dependent on information received from final beneficiaries (such as invoices or statements) which would help measure the satisfaction of performance obligation. This could be particularly relevant at the end of the reporting period, when timely information is necessary for accurate reporting in the accounts.

We would propose that the Standard addresses specifically the application of a best estimate in paragraph 45 for reasonably measuring the satisfaction of performance obligations and hence the resulting asset. This would be similar to the use of best estimate elsewhere in the Standard, for example in measuring expenses and liabilities in paragraph 103.

3) Definitions: cross-references to revenue EDs.

The practical application of ED 72 has been in our view made more difficult than needed as a couple of definitions (e.g. fundamental definition of performance obligation) can only be found in the revenue EDs. Consequently, if an entity only wants to focus on an expense transaction it is rather cumbersome to pull all necessary aspects together and to reverse them in one's mind to the expense side. ED 72 could thus benefit from clear definitions applicable to the expense side.

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?

EU's response:

Based on our reply to SMC 2 we only partly agree with the proposed requirements.

a) As discussed in our reply to SMC 2, we believe that the ED should include an additional category specifically relating to binding obligations without performance obligations where an asset is retained. Alternatively, it should be clarified that there are cases where control over an asset is retained at the point of transferring the *resource, leading to an asset being kept on the balance sheet (with the asset representing the right to require the transfer recipient to carry out specified activities or incur eligible expenses which are in line with the transfer provider's policy objectives). The continuous monitoring of the satisfaction of the contractual obligations would be similar to the cases of binding arrangements with performance obligations.*

In cases where an asset is not retained we agree with the proposed accounting treatment.

b) We agree with the proposal that the transfer provider should measure transfer expenses without performance obligations at the carrying amount of the resources given up.

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?

EU's response:

Based on our reply to SMC 2 we do not think that the lack of symmetry is appropriate

We believe the lack of symmetry is a logical consequence of the basic assumptions underlying the draft Standard.

As pointed out in our reply to SMC 2 we do not agree with the general conclusion that the transfer provider never retains control in the case of a binding arrangement without performance obligation (BC53).

If the standard acknowledged that there are cases under well defined conditions where an asset remains to be recognised, we would expect that the recognition of expenses on the side of the transfer provider and the recognition of revenues on the side of the transfer recipient would be based on the same principle, i.e. the carrying out of specified activities or the incurring of eligible expenses as required by the binding agreement, resulting in a symmetric accounting which we would consider appropriate.

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?

EU's response:

We agree with the proposal.

The Financial Regulation applicable to the general budget of the EU requires a prior authorisation before any legal commitment to transfer funds is entered into. Therefore the fact pattern underlying this specific matter for comment is not relevant to us. However, if for other public entities the arising of a present obligation may precede the appropriation being authorised, we agree with the proposed treatment for those cases.

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?

EU's response:

Based on our reply to SMC 2 we think the disclosure requirements should be expanded.

a) In SMC 2, we propose the addition of a third category of binding arrangements without performance obligations where control is retained. This proposal would subsequently affect the categories of binding arrangements disclosed, although it would not affect the qualitative characteristics of the disclosures. We do not think that any additional disclosure requirements should be included.

b) We have no comments on this point.

Additional matters we would like to comment on

Objectives of the public sector

The standing point of ED 72 (as well as ED 70 and 71) is that the primary objective of most public sector entities is 'to deliver goods or services to the public'.

In many cases, the primary objective of the public sector entities is to implement its policies for the wider benefit of the public, particularly in the case of supra-national bodies such as the EU.

We therefore believe that the obligations defined in the Standard should be linked to this objective.

In the public sector, it is also common to provide a degree of discretion to other organisations or institutions who are knowledgeable in a specific area, to make the specific decisions about achieving the objectives of the public sector entity. This is done within a rigorous legal basis and using legal safeguards. This set-up is in line with the nature of the public sector operations and the reason public entities are set up – not to act merely as a purchaser of specific items (goods or service), but to set strategies and direction in order to benefit the public in a meaningful and efficient way.

An example for this structure is the Shared Management mode in the EU, where the EU issues legislation in the form of a regulation, establishing a fund to provide financial support for a particular area of focus in line with its policy objectives. The EU then shares the responsibilities in controlling and monitoring the expenditure of the fund with each respective Member State. This mechanism ensures efficiency in the administration and in using resources in a productive way for the benefit of the EU citizens.

Purpose of a private vs public sector entity:

Defining the role of public sector entities, as a provider of goods and services (as defined in ED 72) to the public, is probably more relevant to lower levels of government where the existence of each entity is defined by the provision of such specific goods and/or services.

By contrast, many federal, international and supra-national public sector entities achieve their objectives by a much wider range of activities. The individual provision of goods and services is meaningless without achieving of the overarching objectives of the public sector entity.

Parallel with IFRS 15:

The private sector standard IFRS 15 was developed, amongst others, to allow uniformity and clarity in revenue recognition for private sector entities, particularly in the area of complex long-term and often construction related contracts, which resulted in contract assets and liabilities. In order to achieve this, the main stepping-stones in developing the standard were focused on what was actually agreed in the legally binding contract. This was the pivotal point around which the standard was built.

This was developed against the background of numerous revenue recognition practices across a diverse set of industries, which ultimately had one overall purpose – to deliver goods or services to customers for commercial reasons. This does not correspond to the purpose of public sector entities, particularly for supra-national *bodies operating in a highly political context and under different management modes such as the EU.*

We therefore feel that the performance obligations, as defined by ED 72, should be in line with the substance–over-form principle embedded within IFRS 15 – looking into the essence of the contract (or the legal basis) and the legally binding terms.

Applying the same logic to the IPSASB EDs, the legally agreed contract/legal basis would be the analogous starting point for public sector entities. More often than not, such contracts are not for the provision of specific goods and services, but rather for improving the wellbeing of a certain group of society, or contributing to higher objectives, such as health, education, equality, amongst others.

Therefore, applying the same substance–over-form principle, the ED72 should be based on what are typical contracts in the public sector.

Clarity and uniformity:

Some of the main reasons for creating IFRS 15 were to provide clarity in areas which were not addressed in previous standards and uniformity in areas which were interpreted differently across various private sector industries. We fear that in its current form, and also due to its complexity, ED 72 may result in additional confusion and diversity of interpretations.

Performance obligations:

IFRS 15 is based on what is legally agreed between the parties, this is the starting point from which the identification of performance obligation follow. In the private sector what is agreed in a legal contract is the delivery (building/producing/providing etc.) of either goods or services. It logically follows that provision of goods and services, or a combined output of goods and/or services, represent 'performance obligations'.

This is different to the public sector, where a contract may require an entity to implement particular actions or activities in order to achieve the objective of the transfer provider. We therefore see those actions and activities as additional performance obligations in the public sector.

Illustrative Examples

The illustrative examples presented below are intended to demonstrate and provide clarity on the following two scenarios:

1) Our proposal for including a category of binding arrangements with other obligations than performance obligations when control is retained even after funds are transferred;

2) the Shared Management model used by the EU where control responsibilities are shared between the transfer provider and the transfer recipient.

Example 1 Transfer of resources with control being retained

IE1. A supra-national public entity established by sovereign Member States (the 'international public sector entity' or 'IPSE') enters into a binding arrangement to provide a grant of CU50 million to a national Ministry of Transport. The objective of the agreement, which is in line with the policy objectives of the IPSE, is to improve the movement of goods, services and persons in that area by overhauling, upgrading and extending the Member States' cross-border transport infrastructure.

IE2. The binding arrangement describes the individual actions that the Ministry of Transport is obliged to perform, defines the deadlines to observe, the milestones to reach and the means of verification. The continuous and periodic monitoring of the use of the grant is ensured via technical and financial reports, site visits and subsequent audits. If the Ministry of transport does not comply with its obligations in the binding arrangement, or does not spend the funds by the agreed date, the IPSE has the right to have the transferred resources returned (claw-back).

IE3. The binding arrangement gives rise to a transfer expense as the IPSE (the transfer provider) transfers the grant to the Ministry of Transport (the transfer recipient) without directly receiving any goods or services in return. The transfer provider applies IPSAS X (ED 72) in accounting for the binding arrangement.

IE4. The transfer provider analyses if the binding arrangement fulfils the requirement of a binding arrangement with performance obligations. As the Ministry of Transport is not obliged to transfer goods or services to a third party but rather to carry out specified activities or incur eligible expenses the transfer provider determines that these requirements are not fulfilled.

IE5. The transfer provider analyses further if the binding arrangement fulfils the requirements of a binding arrangement without performance obligations where control is retained after the resources are transferred to the transfer recipient. The transfer provider determines that the binding arrangement confers an enforceable right on the transfer provider to require the transfer recipient to carry out specified activities or incur eligible expenses in line with the transfer provider's policy objectives. Furthermore, the binding arrangement establishes a monitoring system, financial and technical reporting requirements, ex-ante and ex-post audits as well as a claw-back mechanism in case of non-compliance with the requirements of the binding arrangement. As a result, the transfer provider concludes that the binding arrangement provides the means to ensure that the resource is used to achieve the transfer provider's objectives, resulting in the transfer provider retaining control even after the resources have been transferred to the transfer recipient. As a consequence, the transfer provider accounts for the binding arrangement as a transfer expense with other obligations where control is retained after the resources are transferred to the transfer recipient. This entails setting up an asset for the resources transferred and releasing it in line with eligible expenses being incurred.

Example 2 Programme under shared management

IE6. A supra-national public entity established by sovereign Member States (the 'international public sector entity' or 'IPSE') has the legal power to issue legislation binding for its Member States regarding the establishment of specific funds to pursue the international public entity's policy objectives as well as the general provisions applicable to the implementation of programmes financed by these funds.

IE7. The international public entity has issued legislation in the form of a regulation, establishing a fund to provide financial support for improving its health system, protecting citizens from health threats and promoting prevention of diseases ('Fund'). The regulation lays down (i) the general and operational objectives, (ii) the actions eligible for financial support, (iii) the strategic priorities for financial support to be provided under the fund, (iv) the general framework for the implementation of eligible actions including the monitoring, reporting and audit requirements, and (v) the global resources to be made available and their distribution among the Member States. A specific feature of the fund is that it is operated under a Shared Management approach in which specific responsibilities are assigned to the IPSE, on the one hand and the Members States on the other.

IE8. The regulation requires the Member States to set up national programmes based on a policy dialogue with the IPSE. The mandatory elements of the national programmes include (i) an appropriate strategy identifying the objectives to be pursued with the provided financial support, with targets for their achievement, an indicative time-table and examples of actions envisaged to meet those objectives, (ii) a description of how the objectives of the fund are covered, (iii) information on the monitoring and evaluation framework to be put in place and the indicators to be used to measure progress in the implementation of the objectives pursued, (iv) a draft financing plan indicatively broken down by each financial year of the national programme. The proposed national programmes are subject to the IPSE's approval. Before approving a national programme, the IPSE examines (i) its consistency with the objectives of the fund and the outcome of the policy dialogue, (ii) the relevance of the objectives, targets, indicators, the time-table and examples of actions, (iii) and the compliance with supra-national law enacted by the IPSE.

IE9. The fund regulation also requires the Member States to fulfil clearly defined management, control and audit obligations and assume the resulting responsibilities. More specifically the Member States (i) shall ensure that their management and control systems for national programmes are set up in accordance with the requirements laid out in the regulation and that those systems function effectively, and (ii) shall allocate adequate resources for each competent authority (a designated body responsible for the proper management and control of the national programme as well as an independent national public authority or body responsible for issuing an annual audit opinion) to carry out their functions throughout the programming period.

IE10. Notwithstanding the shared responsibilities between the IPSE and the Member States, the fund regulation grants the IPSE the right to carry out ex-ante and ex-post on-the-spot audits or controls. The scope of the audits or controls may include, in particular (i) the verification of the effective functioning of management and control systems in a national programme or a part thereof, (ii) the compliance of administrative practices with supra-national law enacted by the IPSE, (iii) the existence of the required supporting documents and their correlation with the actions supported under the national programmes, (iv) the terms on which the actions have been undertaken and controlled, and (v) an assessment of the sound financial management of actions and/or the national programme. Furthermore the IPSE is entitled (i) to receive a refund from the Member State concerned in order to exclude from the financing any expenditure which is in breach of applicable law, including in relation to deficiencies in the management and control systems of Member States which have been detected during an audit, and (ii) where appropriate, to impose effective, proportionate and dissuasive administrative and financial penalties on the Member State.

IE11. Following approval of a national programme the IPSE provides an initial grant of CU25 million to the submitting Member State. The specific actions agreed in the national programme are in line with the fund's policy objectives and comprise (i) measures to improve health awareness and promote healthy lifestyle (ii) projects promoting networking and the exchange of knowledge and recent developments in research, (iii) analytical monitoring and evaluating activities, (iv) communication activities, and (v) measures deploying, transferring, testing and validating new methodology or technology in health care.

IE12. The IPSE determines that the national programme, which is in line with the legal framework established by the fund regulation, constitutes a binding arrangement, as it confers both enforceable rights and obligations on the IPSE and the Member State as parties to the arrangement. This is because (i) the regulation requires the IPSE to provide an initial grant amounting to a fixed percentage of the total volume of the national programme volume within four months after the national programme has been approved, and (ii) the Member State has committed to spend these funds in line with the agreed policy objectives.

IE13. The binding arrangement gives rise to a transfer expense as the IPSE (the transfer provider) transfers the grant to the Member State (the transfer recipient) without directly receiving any goods or services in return. The transfer provider applies IPSAS X (ED 72) in accounting for the binding arrangement.

IE14. The transfer provider analyses if the binding arrangement fulfils the requirement of a binding arrangement with performance obligations. As the Member States are not obliged to transfer goods or services to a third party but rather to carry out specified activities or incur eligible expenses the transfer provider determines that these requirements are not fulfilled.

IE15. The transfer provider analyses further if the binding arrangement fulfils the requirements of a binding arrangement without performance obligations where control is retained after the resources are transferred to the transfer recipient. The transfer provider determines that the binding arrangement confers an enforceable right on the transfer provider to require the transfer recipient to carry out specified activities or incur eligible expenses in line with the transfer provider's policy objectives. Furthermore, the binding arrangement establishes a monitoring system, financial and technical reporting requirements, subsequent audits as well as a claw-back mechanism in case of non-compliance with the requirements of the binding arrangement. As a result, the transfer provider concludes that the binding arrangement provides the means to ensure that the resource is used to achieve the transfer provider's objectives, resulting in the transfer provider retaining control even after the resources have been transferred to the transfer recipient. As a consequence, the transfer provider accounts for the binding arrangement as a transfer expense with other obligations where control is retained after the resources are transferred to the transfer recipient. This entails setting up an asset for the resources transferred and releasing it in line with eligible expenses being incurred.