

15 January 2018

Mr. John Stanford
International Public Sector Accounting
Standards Board
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submitted electronically through the IPSASB website

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Re.: Consultation Paper: Accounting for Revenue and Non-Exchange Expenses

Dear Mr. Stanford,

The IDW would like to thank you for the opportunity to provide the International Public Sector Accounting Standards Board (IPSASB) with our comments on the Consultation Paper: Accounting for Revenue and Non-Exchange Expenses (hereinafter referred to as “the Consultation Paper”).

This letter includes both general comments and comments on specific issues. We respond to the Specific Matters for Comment (SMCs) and the Preliminary Views (PV) in the appendix.

General comments

Support for the project

We support the IPSASB’s project and agree with the majority of the IPSASB’s Preliminary Views, although we question whether the extended obligating event approach is the relevant approach in determining liability recognition for universally accessible services and collective services. In this regard, we specifically refer to our comments on PV 5 in the appendix to this letter, where we discuss whether this approach should be modified in this context.

The IDW firmly supports this project being used as an opportunity to align revisions and any new standards to the IPSASB’s recently completed

GESCHÄFTSFÜHRENDER VORSTAND:
Prof. Dr. Klaus-Peter Naumann,
WP StB, Sprecher des Vorstands;
Dr. Klaus-Peter Feld, WP StB;
Dr. Daniela Kelm, RA LL.M.

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Conceptual Framework. In this context, we strongly encourage the IPSASB to ensure there is no accounting mismatch between the recognition of revenue related to social benefits (explicitly within the scope of this project) and social benefits-related expense (excluded from this project – but dealt with in ED 63) before finalizing either of these projects, and comment specifically on this issue below.

Comments on Specific Issues

Support for changing the categorization of revenue transactions

In our view, the Category A, B and C approach to revenue recognition discussed in the Consultation Paper is likely to result in more appropriate and useful financial information for both accountability and decision-making purposes than the current exchange vs non-exchange differentiation.

Specifically, the IDW agrees that Category A transactions should be addressed in a revised version of IPSAS 23. This would involve matching the recognition of “general” revenue items to the underlying event giving rise to the revenue.

We also welcome alignment of revenue recognition for transactions in Categories B and C to an IFRS 15-equivalent IPSAS tailored to the public sector environment and the IPSASB’s Conceptual Framework, where appropriate. A public sector performance obligation approach (PSPOA), as discussed in the Consultation Paper, that is based on IFRS 15 is an appropriate approach to revenue recognition for funds or other resources provided to a public sector entity when they are intended to fund the delivery of particular services; i.e., when specific performance obligations can be “matched” to the receipt of such revenue.

Recognition and measurement of services in-kind and other donations

We note the discussion in chapter 5 of the Consultation Paper concerning current recognition option in IPSAS 23 for services in-kind and the resultant lack of comparability.

Whilst we agree that the lack of comparability is a valid argument for the IPSASB to revise this aspect of IPSAS 23, it is not the only reason to remove this option. Non-recognition of services in-kind or other donations that enhance service delivery capacity does not meet the objectives of financial reporting in several additional respects. Specifically, not recognizing a service in-kind, or other donation, will deny users appropriate information for accountability and

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decision making purposes (see chapter 2 of the Conceptual Framework, which also specifically refers to donations and donors). Irrespective of their source, all donations, grants, voluntary provision of services etc. that are accepted as having a value in terms of enhancing service delivery by a public sector entity constitute available resources that contribute to the entity's service delivery capacity. (That is not to say that all services in-kind will meet this criterion – some voluntary service schemes may provide work experience to volunteers but little or no enhancement of service delivery capacity and so would appropriately not be recognized). Non-recognition of any (service delivery enhancing) resources that are at the entity's disposal does not result in fair presentation of the entity's financial position and service delivery achievements.

Categorization of revenue – Differentiation from other accounting phenomena

It is to be expected that not all funding arrangements will be sufficiently specific as to lend themselves to unequivocal classification between the three categories discussed in chapter 3 and capital grants discussed in chapter 5 of the Consultation Paper. Indeed, some may represent other accounting phenomena such as equity injections.

In the absence of firm criteria, preparers' views as to the most appropriate classification may be influenced by practical issues, leading to a firm preference in the interpretation of arrangements for which more than one interpretation might have otherwise been possible.

In our view, Category A transactions will generally form a very significant portion of revenue in the public sector; albeit not for every public sector entity. Therefore IPSASB will need to develop robust criteria for determining the transactions classified as Category A. This will be a highly significant aspect of this project.

As far as the differentiation of Category A transactions from Categories B and C is concerned, revenue streams labelled as taxes, contributions and even charges may be so annotated as to imply a link to benefits or services rather than classification as general taxation. We suspect that many such streams will, in substance, constitute general taxation, notwithstanding their individual annotation. For example, specific payroll deductions may carry different labels for reasons of political acceptability, but nevertheless be calculated on the basis of the individual's income instead of carrying a direct link to service delivery or performance obligations. Other perhaps similar revenue items may indeed be directly linked to performance obligations.

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Difference in timing of projects - potential for mismatch in the recognition of revenue and expense for social benefits

As noted in our general comments, thorough coordination will be required with the social benefits project to prevent an accounting mismatch between the recognition of revenue (in this project) and expenses (in ED 63) for social benefits defined in ED 63. Furthermore, given the diversity of social benefit schemes administered throughout the world, the classification of revenue that represents contributions linked to social benefits defined within the IPSASB's social benefits project (ED 63) may be especially challenging. In particular, for such contributions within Category B, the IPSASB will need to develop criteria to determine to what they shall be matched. In some schemes, contributions may need to be recognised as revenue on the basis that in substance they fund benefits to current scheme beneficiaries; in others they may need to be accrued (as liabilities) for future benefits to current and future scheme beneficiaries. Contributions within Category A could not be "matched" in this way.

For this reason, the IPSASB will need to establish robust criteria, whereby factors such as the basis of calculation, existence or absence of a link to performance obligations, whether this is to current or future beneficiaries or a combination of the two, are assessed in determining the appropriate classification in Category A, B or C. We also refer to our response to PV2 in the appendix to this letter.

In some cases, guidance will also be needed to ensure Category A transactions are appropriately differentiated from capital grants and injections of equity (i.e., ownership contributions).

If you have any questions relating to our comments in this letter, we should be pleased to discuss matters further with you.

Yours truly,

Klaus-Peter Feld
Executive Director

Gillian G. Waldbauer
Head of International Affairs

Appendix

Specific Matters for Comment and Preliminary Views

Preliminary View 1 (following paragraph 3.8)

The IPSASB considers that it is appropriate to replace IPSAS 9, Revenue from Exchange Transactions, and IPSAS 11, Construction Contracts with an IPSAS primarily based on IFRS 15, Revenue from Contracts with Customers. Such an IPSAS will address Category C transactions that:

- (a) Involve the delivery of promised goods or services to customers as defined in IFRS 15; and*
- (b) Arise from a contract (or equivalent binding arrangement) with a customer which establishes performance obligations.*

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

We agree. The development of an IPSAS aligned to IFRS 15 and adapted to public sector environment would be appropriate to deal with those public sector contracts and arrangements that have essentially similar economic substance to profit generating contracts common in the private sector – i.e., where there is a clear case for matching a particular recognition of a revenue source with specific service delivery.

We expect that transactions classified as Category B and Category C will generally be treated similarly under this approach.

Preliminary View 2 (following paragraph 3.9)

Because Category A revenue transactions do not contain any performance obligations or stipulations, the IPSASB considers that these transactions will need to be addressed in an updated IPSAS 23.

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

We agree that a revised version of IPSAS 23 would be appropriate to deal with those revenue transactions that cannot be matched to identifiable and specific performance obligations or stipulations (Category A).

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As explained further in our covering letter, robust guidance will be needed in respect of the classification criteria for Category A transactions. In our view, appropriate differentiation of revenue will be particularly important for both this project and the IPSASB's social benefit project (ED 63). The substance of the transaction (e.g., the basis on which it is derived or calculated), rather than how it may be labelled needs to drive the recognition method. In this context, we note that para. 3.3 (a) refers to general taxation receipts and inter-governmental transfers, such as non-specific and non-earmarked grants (underlined for emphasis). Certain revenue sources may appear to be earmarked (e.g., because they are labelled as "contributions to" or "charges for" a particular service), but in substance they may constitute a general tax on income or a tax on another phenomena and thus fall within Category A. In other cases, they might in-substance be social benefit contributions to be dealt in line with in the forthcoming IPSAS on Social Benefits. Criteria to be considered would include whether, and if so how, the practical administration of the service and the basis of calculation actually links this revenue to the specific service delivery. For example, a calculation basis with no clear link to the service coupled with a mismatch between the amount of revenue and the volume of service could indicate that the service is financed from general taxation revenue and not from the "seemingly appropriately" labelled contributions. Such contributions themselves will then fall within Category A. Categorization of such labelled "contributions" and "charges" may need to be determined on a type-by-type or even a case-by-case basis.

We also consider it of paramount importance that contributions that in-substance are social benefit contributions are dealt with in line with the IPSASB's project on Social Benefits (ED 63) to ensure there is no mismatch with the corresponding expense. Specifically, a contribution might not be treated as Category A transaction in line with this project and thus recognized as revenue according to an updated IPSAS 23, when the corresponding expense is accounted for differently under the forthcoming IPSAS on Social Benefits, finalized possibly at a later point in time.

Specific Matter for Comment 1 (following paragraph 3.10)

Please provide details of the issues that you have encountered in applying IPSAS 23, together with an indication of the additional guidance you believe is needed in an updated IPSAS 23 for:

- (a) *Social contributions; and/or*
- (b) *Taxes with long collection periods.*

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If you believe that there are further areas where the IPSASB should consider providing additional guidance in an updated IPSAS 23, please identify these and provide details of the issues that you have encountered, together with an indication of the additional guidance you believe is needed.

As non-preparer in a jurisdiction that does not apply IPSAS, the IDW is not in a position to respond.

Preliminary View 3 (following paragraph 4.64)

The IPSASB considers that Category B transactions should be accounted for using the Public Sector Performance Obligation Approach.

Do you agree with the IPSASB's Preliminary View 3? If not, please give your reasons.

We agree that Category B transactions may be most appropriately accounted for under a Public Sector Performance Obligation Approach specially developed for the public sector.

Specific Matter for Comment 2 (following paragraph 4.64)

The IPSASB has proposed broadening the requirements in the IFRS 15 five-step approach to facilitate applying a performance obligation approach to Category B transactions for the public sector. These five steps are as follows:

Step 1 – Identify the binding arrangement (paragraphs 4.29-4.35);

Step 2 – Identify the performance obligation (paragraphs 4.36-4.46);

Step 3 – Determine the consideration (paragraphs 4.51-4.50);

Step 4 – Allocate the consideration (paragraphs 4.51-4.54); and

Step 5 – Recognize revenue (paragraphs 4.55-4.58).

Do you agree with the proposals on how each of the IFRS 15 five-steps could be broadened? If not, please explain your reasons.

We generally agree that a five step revenue recognition approach mirroring that in IFRS 15 but adapted to public sector specifics will be appropriate (public sector performance obligation approach (PSPOA)).

Step 1: Identify the binding arrangement. We agree that many arrangements in the public sector will not be governed by a single and enforceable contract, as would likely be the case in the private sector. Consequently sufficient flexibility will be needed in assessing whether or not a binding arrangement exists.

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Guidance – possibly along the lines of para. 4.32 – will be needed to support preparer judgments needed in this regard.

Step 2: Identify the performance obligations. The description of Step 2 in the Consultation Paper seems to mix elements of Step 5 (satisfaction) with Step 2 (identification). In developing this approach in a final standard public sector specific guidance on this will need to be developed.

In developing this revenue recognition step for public sector application, it needs to be clear that the purpose of identification is not first and foremost to determine whether a particular good or service required to be provided is actually distinct from another good or service for the recipient (although information on separate service lines may be needed for other purposes). The key issue is whether the method and particularly the timing of provision (i.e., when control passes) differ. Specifically, provision of a one-off service (e.g., an inoculation to individuals within a given population undertaken in stages) will need to be differentiated from a service provided at regularly recurring intervals (e.g., monthly waste disposal), and constant, continuous service provision (e.g., availability of basic utilities). Thus where a range of services is concerned, it is this aspect rather than distinctness of each service per se that will be key in bundling non-distinct services in order to identify performance obligations (see paras. 4.42 and 4.43).

We further question the general assumption in para. 4.45 that the lack of specification of the nature or quantity of services (only specified time frame) will always mean that there is no performance obligation and thus the revenue will classify as Category A. However, if the entity provides a single type (bundle) of services, lack of specification or even an announced intention to fund the entity's general internal activities would, in substance, support that particular service provision (similar to fixed administration costs that would form part of indirect cost of sales in a private sector profit generating environment) and so there may be a case for categorizing such revenue as Category B or C. In our opinion, where consideration is provided for a specified time period without specifying a particular performance obligation, instead of simply making any such assumption, preparers would need to assess the possible use put to such consideration to support its recognition as revenue only in the period of receipt.

Steps 3 and 4: Determine and allocate the consideration. In the public sector context, it is important to underline that in comparison to the private sector it will be cost coverage over time and availability of funding rather than profitability that is likely to be the key consideration for the entity tasked with provision of a good or service. Often the exact amount of consideration will be fixed, and thus

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the level of service provision must be “cut to fit the cloth”. In other cases the entity may be required to adjust future charges to compensate for a (temporary) surplus or shortfall. Given this, as well as our comments concerning the purpose of an identification of performance obligations, we agree that an IFRS 15-driven emphasis on establishing a stand-alone selling price for a particular good or service is likely to be misplaced in a public sector context.

Step 5: Recognize revenue. The phrase “when (or as) the public sector entity fulfils its performance obligations” (see paras 4.56-58) is intended as the public sector equivalent of the IFRS terms of “satisfaction of a performance obligation” and “transfer of control” (see IFRS 15.31 et. seq.). In our opinion further clarification of the criteria to determine the principle of “fulfilling a performance obligation” will be needed.

Under the proposed PSPOA approach, we fully agree that where fixed consideration is concerned, the provision of goods and services or construction of a capital item should be the key factor in determining the point in time of revenue recognition and not the timing of actual receipt of corresponding consideration. Advance receipt of consideration for goods and services yet to be provided would give rise to a liability for the recipient entity to perform the goods and services delivery obligation. We refer to comments in the covering letter and our response to SMC 5 below in regard to the need for IPSASB to consider requiring presentation of an “other obligation” in the statement of financial position where capital grants have been received but funds remain unspent at the financial reporting date.

Specific Matter for Comment 3 (following paragraph 4.64)

If the IPSASB were to implement Approach 1 and update IPSAS 23 for Category B transactions, which option do you favor for modifying IPSAS 23 for transactions with time requirements (but no other stipulations):

- (a) Option (b) – Require enhanced display/disclosure;*
- (b) Option (c) – Classify time requirements as a condition;*
- (c) Option (d) – Classify transfers with time requirements as other obligations; or*
- (d) Option (e) – Recognize transfers with time requirements in net assets/equity and recycle through the statement of financial performance.*

Please explain your reasons.

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As noted above, we support the IPSASB's proposed move from its present exchange vs non-exchange approach to the PSPOA.

Subject to this, were the IPSASB to revise IPSAS 23 to encompass transactions within Category B, we would have a preference for option (d), on the basis that this approach is in line with the Conceptual Framework using the potential for presentation of "other obligations" thus enabling revenue to be recognized over time where appropriate, rather than only in the period of receipt.

Specific Matter for Comment 4 (following paragraph 4.64)

Do you consider that the option that you have identified in SMC 3 should be used in combination with Approach 1 Option (a) – Provide additional guidance on making the exchange/non-exchange distinction?

- (a) Yes
- (b) No

Please explain your reasons.

As noted above, we support the IPSASB's proposed move from its present exchange vs non-exchange approach to the PSPOA for Category B transactions.

Subject to the above, we agree that additional guidance under option (a) together with option (e) would be appropriate, if contrary to our views the IPSASB were to revise IPSAS 23 to encompass transactions within Category B.

Preliminary View 4 (following paragraph 5.5)

The IPSASB considers that accounting for capital grants should be explicitly addressed within IPSAS. Do you agree with the IPSASB's preliminary view 4? If not please give your reasons.

We agree that it is appropriate for the IPSASB to address the accounting for capital grants in an IPSAS. We refer to our comments in the covering letter in this regard.

Specific Matter for Comment 5 (following paragraph 5.5)

- (a) *Has the IPSASB identified the main issues with capital grants? If you think that there are other issues with capital grants, please identify them.*

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(b) Do you have any proposals for accounting for capital grants that the IPSASB should consider?

Please explain your issues and proposals.

We agree that the Consultation Paper has identified the main issues relevant to accounting for capital grants.

In Germany, the accounting provisions under commercial law would permit a capital grant provided for the purpose of purchasing or constructing an asset, irrespective of whether in part or in full, to be either netted against the initial cost of that asset or initially recognized as a specific item (Sonderposten für Zuwendung) in the statement of financial position, which would then be released (as revenue) over the useful life of the asset. The IDW has consistently expressed its preference for the second option, and notes that the public sector entities applying accruals accounting in Germany generally present such capital grants as a specific item between equity and external debt and release over the useful life of the relevant asset.

As discussed in our covering letter, the IDW has concerns about non-recognition of donations because such treatment does not provide useful information as to the entity's financial position or service delivery. Similarly, offsetting capital grants against the cost of the asset is not our preferred option. We appreciate that recognizing a credit item ("other obligation") in the statement of financial position in line with the IPSASB's Conceptual Framework is the more appropriate option, since such a credit item (quasi-liability) will not meet the definition of either equity or a liability.

Whilst we understand the logic in regard to the current accounting for revenue subject to a repayment clause, we believe that usually no liability should be recognized until such time as specific events or circumstances occur that will trigger an obligation to repay. At the start of an arrangement there would not be any intent to repay revenue (or logically, there is no sound basis for entering into the arrangement). Thus on initial receipt of e.g., cash to fund the building of a swimming pool, a liability to repay would not be recognized.

Specific Matter for Comment 6 (following paragraph 5.9)

Do you consider that the IPSASB should:

- (a) Retain the existing requirements for services in-kind, which permit, but do not require recognition of services in-kind; or*
- (b) Modify requirements to require services in-kind that meet the definition of an asset to be recognized in the financial statements provided that they*

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can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information: or

(c) *An alternative approach.*

Please explain your reasons. If you favor an alternative approach please identify that approach and explain it.

As discussed in the covering letter, we do not support retention of the existing option for accounting for services in-kind. The non-recognition of donations, including services in-kind, that enhance service delivery capacity denies users appropriate information for accountability and decision making purposes and therefore does not meet the objectives of financial reporting.

In our view, the IPSASB should follow (b) and (c) and revise the existing requirements, whereby the individual circumstances in conjunction with application of the IPSASB's Conceptual Framework should dictate the accounting treatment.

When services in-kind fulfil the criteria for asset recognition, IPSASB should require they be recognized as an asset (and a corresponding donation recognized in accordance with the terms of the arrangement).

Unless the entity has control of the donated service (i.e., it has recourse if the service is not delivered) the entity would not be able to recognize an asset. Such services in-kind would be most appropriately accounted for by recognizing an expense and corresponding revenue on an ongoing basis as and when they are delivered. In terms of financial reporting of service delivery (comparability and relevant information as to the cost of services) there is, in substance, no difference between donated time or paid for time.

Whether or not the services would have been purchased had they not been donated is not relevant if the donation is accepted and used in service delivery (there may be possibly a measurement issue, if services rendered were inferior in terms of quality compared to services paid for or service delivery slower etc. however this is a measurement issue). Indeed, not accounting for services in-kind would prevent information on service delivery being useful and comparable, especially where an entity were fortunate to have been donated services in-kind, the equivalence of which would have to be paid for by another entity.

Of course, the qualitative characteristics identified in the IPSASB's Conceptual Framework would apply in determining whether donated items or services are material alone or in the aggregate (whether quantitatively or qualitatively).

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Preliminary View 5 (following paragraph 6.37)

The IPSASB is of the view that non-exchange transactions related to universally accessible services and collective services impose no performance obligations on the resource recipient. These non-exchange transactions should therefore be accounted for under The Extended Obligating Event Approach.

Do you agree with the IPSASB's Preliminary View 5? If not, please give your reasons.

In line with our responses to the PVs and SMCs relating to revenue recognition, we accept that the Public Sector Performance Obligation Approach is not appropriate for accounting for expenditure for items that would be a counterpart to Category A, including universally accessible services and collective services.

We agree that non-exchange transactions related to universally accessible services and collective services impose no performance obligations on the resource recipient. Indeed, this means that the last boxes in the diagram on page 53 of the Consultation Paper depicting the so-called "extended obligating event approach" are not relevant in determining accounting for universally accessible services and collective services. Consequently, it would be appropriate to delete the last two boxes on the left hand side of the diagram and the last box on the right hand side.

It then becomes clear (whatever this amended approach were called) that the focus needs to be on determining whether or not there is a non-legally binding obligation that would give rise to a liability. In the absence of both a legally binding and non-legally binding obligation the entity will recognize an expense only.

In considering this aspect, we concur with the IPSASB's argument that, whilst there may be an expectation that universally accessible services and collective services will be delivered in future, factors listed in the Conceptual Framework including the ability of the entity to modify or change the service delivery (see para. 5.25) means that these expectations will generally not give rise to obligating events and consequently the liability recognition criteria are not satisfied.

In our view, it is the distinction between the past events leading to these more "imprecise" expectations of availability of universally accessible services and collective services going forward, and a more "tangible" expectation based on the perception of a far firmer personal entitlement (which may be legally binding or otherwise) that provides a direct contrast to certain social benefit schemes. For example in relation to pensions, factors such as the long-term contribution

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by private individuals coupled with their lack of alternative means of support serve as a compelling arguments that the public sector entity does not have a realistic alternative to an outflow of resources. Such factors are missing in relation to universally accessible services and collective services.

Indeed, given potential diversity in service delivery and the various constructs worldwide for service delivery, we believe it may not always be appropriate to consider all so-named universally accessible services and collective services as equivalent in this context. A type-by-type, if not a case-by-case analysis may be needed to establish liability recognition especially where an individual citizen's involuntary contributions may appear to be earmarked for a specific service delivery such that a distinct entitlement is perceived – or even set forth in law. We would therefore encourage the IPSASB to develop robust criteria – particularly in relation to any relationship between individual contribution and future entitlement – in defining universally accessible services and collective services.

Preliminary View 6 (following paragraph 6.39)

The IPSASB is of the view that, because there is no obligating event related to non-exchange transactions for universally accessible services and collective services, resources applied for these types of non-exchange transactions should be expensed as services are delivered.

Do you agree with the IPSASB's Preliminary View 6? If not, please give your reasons.

Subject to our remarks in response to PV 5, we agree that expenses should be recognized in line with ongoing provision of universally accessible services and collective services.

Preliminary View 7 (following paragraph 6.42)

The IPSASB is of the view that where grants, contributions and other transfers contain either performance obligations or stipulations they should be accounted for using the PSPOA which is the counterpart to the IPSASB's preferred approach for revenue.

Do you agree with the IPSASB's Preliminary View 7? If not, please give your reasons.

We agree with the IPSASB's view, and also refer to our comments in response to earlier (counterpart) SMCs and PVs in this context.

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Preliminary View 8 (following paragraph 7.18)

The Board considers that at initial recognition, non-contractual receivables should be measured at face value (legislated amount) of the transaction(s) with any amount expected to the uncollectible identified as an impairment.

Do you agree with the IPSASB's Preliminary View 8? If not, please give your reasons.

We agree with the IPSASB's view, and do not support the other option identified in the Consultation Paper at all, since not reporting on uncollectable amounts will not fulfill the accountability and decision-making usefulness objectives of financial reporting.

Preliminary View 9 (following paragraph 7.34)

The IPSASB considers that subsequent measurement of non-contractual receivables should use the fair value approach.

Do you agree with the IPSASB's Preliminary View 9? If not, please give your reasons.

We agree that subsequent measurement of non-contractual receivables should use the fair value approach.

Specific Matter for Comment 7 (following paragraph 7.46)

For subsequent measurement of non-contractual payables do you support:

- (a) Cost of Fulfillment Approach;*
- (b) Amortized Cost Approach;*
- (c) Hybrid Approach; or*
- (d) IPSAS 19 requirements?*

Please explain your reasons.

In our view the requirements of IPSAS 19 (i.e., the best estimate of the expenditure required to settle the present obligation at the reporting date) would likely be appropriate for the subsequent measurement of many non-contractual payables.