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Public Sector Accounting Board

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International Public Sector Accounting Standards Board (IPSASB)
277 Wellington Street West
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Re: Draft Response to Exposure Draft (ED) 72, *Transfer Expenses*

Thank you for the opportunity to provide input on a future International Public Sector Accounting Standard on transfer expenses.

PSAB staff believe that amendments are required before a standard on transfer expenses should be issued.

The theoretical supportability of the proposed standard hinges on making the case that an asset arises for a transfer provider in relation to a transfer provided to a recipient that imposes a performance obligation on the transfer recipient. We do not feel that this case has been sufficiently made. Specifically:

- We disagree with the assertion that the existence of a performance obligation for a transfer recipient gives rise to an asset of a transfer provider.
- We do not believe that the Public Sector Performance Obligation Approach (PSPOA) developed for revenue can be flipped and applied to transfer expenses while also adhering to the element definitions in the conceptual framework.

PSAB staff recognize that even if the case cannot be made that the asset definition is met by the transferor when it has imposed a performance obligation on a transfer recipient, the IPSASB may still decide to allow expense recognition of transfers for which a transfer recipient has a performance obligation over the future periods in which the performance obligation is met by the recipient. The IPSASB may want to do so for pragmatic reasons. Or there may be political support from governments for the PSPOA approach for transfer expenses especially because of the massive spending by governments worldwide to respond to the pandemic. If the Board proceeds with the PSPOA approach for some transfer expenses and wants to preserve the integrity of the asset definition, the IPSASB would seem to have two choices:

(i) Use the “other resources” category to recognize the transfer outside of assets.

Concern: Unfortunately, this choice could set a precedent for recognizing deferrals in this category and such precedent could be a slippery slope to recognition of more deferrals on the statement of financial position that don't meet the asset or liability definitions.

(ii) Pragmatically justify use of the PSPOA for transfer providers as an exception to the conceptual framework in order to parallel the requirements for revenue recognition of transfers when there is a recipient performance obligation.

Concern: This choice would be forced symmetry for one aspect of the proposed standard, while in other cases in the same standard symmetry would not be forced. The PSPOA approach to transfer expenses does provide the IPSASB with a way forward on a complex public sector topic that has already been tested for its merits in relation to revenue in the private sector. We do not agree that symmetrical accounting by a transfer provider and transfer recipient can always be justified by the economic substance of the arrangement to each party and their available evidence to support recognition. However, we acknowledge a pragmatic choice to use the PSPOA for some transfer expenses may be deemed necessary. See our comments on Specific Matter for Comment 7 in **Appendix A**.

We elaborate on our concerns here and in the responses to the Specific Matters for Comment in **Appendix A**.

1. Proposal that Transfer Expenses can Create an Asset for the Transfer Provider:

PSAB staff do not agree with this proposal. It not only conflicts with the position taken by PSAB in Canada given the definition of an asset in our framework, but more importantly, we do not feel that the case has been made for asset recognition within the IPSASB conceptual framework.

Existing Canadian position: GOVERNMENT TRANSFERS, Section PS 3410, of the Canadian Public Sector Accounting (PSA) Handbook takes the position that a transfer provider would not have an asset in relation to a transfer unless the transfer recipient breached the transfer terms and the transfer provider expects to get some or all of the transferred resources returned to it. For the transferor, a transfer is not an exchange transaction equivalent to a purchase or sale, an investment or a loan. By definition, a transferor gives away economic resources and thus reduces the resources that it holds itself. It does not directly receive a benefit that is economic in exchange for transferred resources, as would be required by the asset definition. Thus, a transferor incurs an expense and does not acquire an asset when providing a transfer. Transfers are a redistribution of wealth. They may provide funding to recipients to provide goods or services to the population, but the transferor does not acquire those services for itself as would occur, for example, in a purchase of insurance for a future period.

Note: The Canadian standard, GOVERNMENT TRANSFERS, Section PS 3410, would not allow the accounting in paragraph 2(a) of ED 72. Section PS 3410 takes an ED 72 paragraph 2(b) approach. Please see **Appendix C** to this letter.

The Case for Asset Recognition by the Transfer Provider is Not Persuasive: The Basis for Conclusions for ED 72 sets out the supporting reasoning for a transfer provider to recognize as an asset the right to have goods or services transferred to specified third parties. It notes that a transfer provider has control over such a resource when a binding arrangement provides it with the means to ensure the resource is used to achieve the transfer provider's objectives.

We are concerned that the boundaries of what is an asset are being stretched. Some of our more specific issues are:

(a) ***Distinction from Contractual Rights:*** The distinction is not clear between a contractual right that qualifies for disclosure and a right to have goods or services delivered to 3rd parties under a binding arrangement that qualifies for asset recognition. ED 72 Basis for Conclusions paragraph BC 32 indicates that the past event is the entering into the binding arrangement. This conclusion raises the possibility that many other contractual rights arising from binding arrangements could also be recognized as assets. In Canadian GAAP contractual rights qualify for disclosure, and CONTRACTUAL RIGHTS, paragraph PS 3380.05 defines contractual rights as follows:

> **Contractual rights** are rights to economic resources arising from contracts or agreements that will result in both an asset and revenue in the future.

(b) ***Distinction from Other Contracts/Arrangements or Performance Obligations Imposed on Others:*** Public sector entities exist to serve the public. Subordinate to that overriding objective are multiple public interest objectives, which are met directly through government service provision or income redistribution, or indirectly through arrangements with other entities to deliver government programs.

The distinction for meeting the asset definition between a transfer and expenses under other program spending of a public sector entity is not clear. Clearly the existence of a binding arrangement is a distinction. However, a public sector entity may have many program commitments, some of which are fulfilled through formal binding arrangements contracting with external parties to deliver services on the entity's behalf. We believe some questions remain to be addressed:

- Would program commitments, some of which are fulfilled through formal binding arrangements contracting with external parties to deliver services on the entity's behalf, also be recognized as assets until the external parties deliver the services?

- Or would they only be recognized as assets of the public sector entity if it had prepaid the external parties for future delivery of services?
- How does this type of "prepaid services to 3rd parties" differ from transfers to recipients to provide future services to 3rd party beneficiaries?
- Would a public sector entity have an asset if it imposed a performance obligation on an external party through means other than through a transfer?
- What other types of expense transactions in the public sector could/should the Public Sector Performance Obligation Approach (PSPOA) be extrapolated to?
- Would such extrapolation be appropriate? The revenue proposals in EDs 70 and 71 apply to all revenue; but the reverse of the PSPOA applies only to transfer expenses.

(c) ***Arguably, Transferor Performance is Complete When Resources Provided:*** While they may be the result of a binding arrangement, "performance" of the transfer provider comprises providing resources to the transfer recipient. The existence of a performance obligation for a transfer recipient does not create an asset for the transferor. Such an approach delays expense recognition of transfer programs beyond the point of when a present obligation exists for the transfer provider.

(d) ***Does a Binding Arrangement Convey Control?*** Is a binding arrangement requiring the transfer recipient to provide goods and services to 3rd party beneficiaries sufficient to assert that the transfer provider has the *means to ensure the transferred resources are used to achieve the transferor's objectives*; i.e., that the transferor has control? This is only one indicator of control (IPSASB Conceptual Framework, indicators of control, paragraph 5.12) and on its own may be insufficient to indicate that the transferor controls an economic resource.

(e) ***Transferor Choice Whether to Monitor Recipient Performance is a Decision Whether to Exercise Control:*** We are also concerned that the ED 72 proposals allow the transferor to decide to monitor – or not – the progress of the transfer recipient in fulfilling the performance obligation imposed by the transferor. This choice is in essence whether the transferor will exercise control over the "asset" or not. We do not believe that the exercise of control determines whether an entity has an asset or not. Control of an asset is a question of fact; whether it is exercised or not does not negate the existence of control. We discuss other aspects of this transferor choice in Specific Matter for Comment 3 in **Appendix A**.

(f) ***Extrapolation: Is the asset definition met for a transfer provider when a transfer recipient has a present obligation that is not a performance obligation?*** Why does a performance obligation imposed on a transfer recipient give rise to an asset of the transfer provider but imposing a present obligation on a transfer recipient does not give rise to an asset for the transfer provider?

A performance obligation is a type (subset) of present obligation.

So, what are the characteristics of a performance obligation that mean that a performance obligation imposed on a transfer recipient gives rise to an asset of the transfer provider but imposing a present obligation on a transfer recipient does not?

This would be an extrapolation beyond the symmetry being proposed in ED 72 regarding transfer provider and transfer recipient accounting when a performance obligation is imposed on a transfer recipient by the transferor. However, it is important to understand why one specific type of present obligation – i.e., performance obligations – creates an asset for a transfer provider when other types of present obligations imposed on a transfer recipient do not.

And further, as mentioned above, it is not clear how or if the PSPOA for transfer expenses would be applied to other situations (i.e., other than a transfer) in which a public sector entity imposes a performance obligation on a third party.

2. Implications for the Budgets of Transfer Providers:

The PSPOA approach for transfer expenses adds complexity to the budget process of transfer providers. Budgeting for transfer expenses under the PSPOA is dependent on the extent of transfer recipients' performance under each transfer arrangement as well collectively for all transfer arrangements, and also the timeliness and quality of the transferor's monitoring of such performance. Judgments would need to be made of expected transfer recipients' performance for the upcoming fiscal period, which could be subjective and complex and require a process for evaluating all outstanding arrangements. There could also be behavioural implications such as the potential that entities would budget for the worst-case scenario, leaving less room for other budget priorities. Transparency of the budget process might be impaired.

3. Complexity of the Standard + Extent of Disclosures/Record Keeping

We understand that many of the proposals in EDs 70, 71 and 72 are aligned with IFRS 15, *Revenue from Contracts with Customers*, amended as appropriate for the public sector. We are concerned with the complexity of these proposed standards and the extent of the related disclosures for smaller public sector entities. While this issue for smaller entities is not unique to these proposals, we felt the concern should be raised. A related issue may be the need to create a database to record and track all transfer arrangements subject to recognition in expenses using the PSPOA approach (a similar issue may exist for revenue under the ED 71 proposals).

4. Understandability and Ease of Application

In terms of ensuring understandability and ease of application of various IPSAS and their interaction, we suggest that:

- Table 1 in the "At a Glance" document illustrating how the three exposure drafts (EDs 70, 71 and 72) interact be retained as an appendix in each of the standards. Or, alternatively, some other location within in the IPSAS could provide relevant overviews of the interaction of various IPSAS such as this one to improve understandability of the whole body of the IPSAS.
- Figure 1 in the "At a Glance" document illustrating the Accounting for Transfer Expenses be retained as an appendix in the standard created from ED 72.
- Reference be provided in the final standard to the table in IPSAS 42 (Page 60 of IPSAS 42; revised version on page 72 of ED 72) that indicates which inter-related standard to apply: IPSAS 42, *Social Benefits*, Amendments to IPSAS 19, *Collective and Individual Services*, or the standard created from ED 72, *Transfer Expenses*.

The comments set out in this letter and the appendices represent the views of PSAB staff, not those of the Public Sector Accounting Board (PSAB). The appendices include:

- **Appendix A**: Responses to Specific Matters for Comment
- **Appendix B**: Other Issues
- **Appendix C**: Canadian Comparison and Implications

We hope that you find the comments helpful. We are happy to discuss them at any time.

Best regards,

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APPENDIX A – RESPONSES TO SPECIFIC MATTERS FOR COMMENT

Specific Matter for Comment 1:

The scope of this [draft] Standard is limited to transfer expenses, as defined in paragraph 8. The rationale for this decision is set out in paragraphs BC4–BC15.

Do you agree that the scope of this [draft] Standard is clear? If not, what changes to the scope or definition of transfer expenses would you make?

PSAB Staff Response

Transfer Expenses Definition: PSAB Staff generally agree that the definition of transfer expenses is clear.

We offer the following clarifications for consideration, based on the definition of a transfer from GOVERNMENT TRANSFERS, paragraph PS 3410.04:

> Government transfers are transfers of monetary assets or tangible capital assets from a government to an individual, an organization or another government for which the government making the transfer does not:
>
> (a) receive any goods or services directly in return, as would occur in a purchase / sale or other exchange transaction;
>
> (b) expect to be repaid in the future, as would be expected in a loan; or
>
> (c) expect a direct financial return, as would be expected in an investment.

Suggestion: Consider adding as clarification in the IPSAS that:

> "In return for a transfer, a transferor does not expect to be repaid in the future, as would be expected in a loan. Nor does the transferor expect a direct financial return from a transfer, as would be expected in an investment."

Scope of the Proposed Standard: PSAB Staff generally agree with the scope of the proposed standard but suggest the following:

1. Types of Transfer Expenses: Some clarity regarding the three types of transfer expenses addressed in the ED before paragraph 7 would be helpful. Paragraph 7 introduces binding arrangements out of the blue, with no context for why binding arrangements need to be discussed.

   The chart on page 72 of ED 72 indicates that there are three types of transfer expenses, which should probably be identified up front in the standard:

   (a) transfer expenses with performance obligations;

(b) transfer expenses without performance obligations but with binding arrangements (present obligation);

(c) transfer expenses without performance obligations or binding arrangements.

2. <u>Hierarchy of Accounting for Transactions that are Binding Arrangements:</u> Some clarity around operationalizing the provisions in ED 72 paragraph 7(a) is needed.

> (a) If the other Standards specify how to separate and/or initially measure one or more parts of the binding arrangement, then an entity shall first apply the separation and/or measurement requirements in those Standards. An entity shall exclude from the transaction consideration or other transfer of resources the amount of the part (or parts) of the binding arrangement that are initially measured in accordance with other Standards and shall apply paragraphs 72–85 (transfer expenses with performance obligations) or paragraphs 102–114 (transfer expenses without performance obligations) to account for the amount of the transaction consideration or other transfer of resources that remains (if any).

Specifically, paragraph 7(a) seems to be indicating that some binding arrangements might involve a transfer expense as well other types of transactions that are addressed in other IPSAS. Then, it seems to say that existing IPSAS that are relevant would be applied first, using any separation and/or initial measurement requirements in those IPSAS. Any item that remains would be a transfer expense accounted for in accordance with ED 72 and any related separation and/or measurement provisions in ED 72. Our questions surrounding this guidance are as follows:

- If more than one other IPSAS applies to a binding arrangement in addition to ED 72, in what order would they be applied?
- Do different IPSAS contain different separation and/or initial measurement requirements such that different entities individually applying paragraph 7(a) to a similar transfer would end up accounting for a different amount or percentage of the transaction as a transfer expense?
- While we recognize that the linkages with other IPSAS can be helpful in ensuring internal consistency in application of the IPSAS to items of similar economic substance, we wonder whether in practice, application of paragraph 7 may be unnecessarily complex?

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?

PSAB Staff Response

PSAB Staff are uncomfortable with the distinction made in ED 72 between transfers with performance obligations and transfers without performance obligations because we do not believe that performance obligations imposed by a transferor on transfer recipients give rise to an asset of the transfer provider. We do not agree that the asset definition is met for the transfer provider.

The transferor will not be owed anything unless the transfer stipulations are breached in the future. The ultimate beneficiaries of the goods or services to be provided by the transfer recipient with the transferred resources are not owed anything either – they are not party to any contract or agreement with the recipient unless some future event occurs. In addition, any external providers that might be contracted with to deliver the goods and services contemplated in the transfer agreement to the ultimate beneficiaries are also not owed anything unless a future event occurs.

Please also see our comments in the covering letter and in response to Specific Matter for Comment 4 below.

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?

PSAB Staff Response

We like the fact that the default approach if a transferor decides not to monitor recipient performance is substantially the same as the approach for all transfer expenses in Canada. However, we are not persuaded that this transferor choice is appropriate. The "At a Glance" document indicates that:

> The transfer provider must monitor the satisfaction of the transfer recipient's performance obligations throughout the duration of the binding arrangement. This is necessary to ensure the transfer provider has the information required to apply the PSPOA.

So, the onus for monitoring recipient performance under the arrangement is on the transferor. If it chooses not to monitor the recipient's performance, this decision determines its accounting for the transfer; that is, earlier timing of expense recognition.

Choice to Monitor or Not: So, a transferor can book an asset if it wants to – if it decides to do the work to substantiate that performance is still all or partially unfulfilled and thus substantiate the existence and measurement of the asset. Or it can choose not to monitor and have earlier expense recognition. Presumably, it can also decide to stop and restart monitoring the recipient's progress with its performance obligation. We could not ascertain if the ED 72 proposals would disallow this behaviour. We note that ED 72, paragraph 151 requires disclosure of an "inability" to monitor and the reasons why the entity is "unable to monitor". So, there is some accountability to stakeholders when an entity chooses not to monitor.

Suggestion: If the IPSASB retains this transferor choice to monitor in the final standard, in addition to the disclosure requirement in ED 72, paragraph 151, we suggest the IPSASB consider including a requirement for an entity to decide its approach at the inception of the transfer and consistently apply that approach for the term of the arrangement.

What does the transferor's decision to monitor or not represent – in terms of meeting the asset definition?

ED 72, paragraph BC31 states:

> The transfer provider will have an enforceable right under the binding arrangement to have goods or services transferred to a third-party beneficiary. The IPSASB concluded that, as a result of this enforceable right, the transfer provider will have the means to ensure that the resource is used to achieve the transfer provider's objectives. The IPSASB agreed that means that the transfer provider presently controls the resource.

A decision not to monitor the recipient's progress in fulfilling its performance obligation could be seen as a decision to relinquish or at least not exercise the control acquired through the enforceable right in the binding arrangement.

For asset recognition, we believe that the key is whether control exists or does not. It is not a question of whether the entity chooses to exercise that control or not. We believe that this applies equally to control of an asset or control of another entity. As an example, GOVERNMENT REPORTING ENTITY, Section PS 1300, of the Canadian Public Sector Accounting (PSA) Handbook, states:

> .08 Control is the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities.
>
> .09 A government may choose not to exercise its power; nevertheless, control exists by virtue of the government's ability to do so. Control must exist at the financial statement date, without the need to amend legislation or agreements.

Suggestion: We encourage the IPSASB to consider whether allowing the transferor to decide to exercise control or not conflicts with the theory underlying the asset definition.

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?

PSAB Staff Response

We do not believe that a transfer provider imposing a performance obligation on a transfer recipient and the recipient's progress in fulfilling that obligation should impact the timing of recognition of expenses by the transferor. PSAB staff believe that an ED 72 paragraph 2(b) approach should be applied to all transfers provided regardless of whether a performance obligation has been imposed on a transfer recipient.

However, should the IPSASB decide to continue with the PSPOA for transfer expenses as proposed in the ED, we agree that the proposals for expense recognition above related to transfers with performance obligations would work, as long as the transfer provider does not identify the transfer provided as an asset but rather as an "other resource". Please note, however, that we are uncomfortable that "other resources" could be used for what is essentially deferrals of transfer expenses (i.e., beyond the point at which the transfer provider has a present obligation). And we note the complexity of the PSPOA for smaller public sector entities; however, we recognize that a smaller entity's pragmatic choice not to monitor recipient performance would allow it to follow the simpler accounting in ED 72 paragraph 2(b).

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.

PSAB Staff Response

PSAB staff believe that ED 72 already contemplates difficulties with applying the recognition and measurement requirements for transfer expenses with performance obligations – either because monitoring of the recipient's fulfillment of its performance obligation(s) is difficult, or reliant on recipient reporting or the transfer provider chooses not to try and monitor performance. ED 72, paragraph 13 notes:

> [ ] paragraphs 90–114 (i.e., as a transfer expense without performance obligations). Consequently, unless a transfer provider monitors the satisfaction of the transfer recipient's performance obligations throughout the duration of the binding arrangement, the transaction is accounted for as a transfer expense without performance obligations.

PSAB staff agrees that assessment of when a third-party beneficiary gains control or measuring progress towards complete satisfaction of performance obligation may be difficult and onerous.

Further, the PSPOA approach results in some cases in creation of a temporary asset (i.e. transfer provider's binding arrangement asset). Although under this approach the accounting for this item as asset appears logical, it is generally counterintuitive that a transferring government would recognize an asset. This is because the transferring government is not receiving goods or services in return. Please also see our comments on temporary assets in **Other Issues, Appendix B, Issue 3** below.

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?

PSAB Staff Response

Yes. We agree with the proposals regarding the point of recognition (in (a) above) as well as the measurement proposal of the carrying amount of the resources given up (in (b) above).

However, we request that the IPSASB consider the following question.

Question: Is it possible that the transfer provider would always have an expense earlier than the point(s) at which it provides resources to the transfer recipient(s)? That is, the transferor would have a liability and an expense when the transfer is authorized?

Explanation: It might seem that we are just then referring to an ED 72 paragraph 91(a) scenario, in which a present obligation exists. And perhaps our question arises because in Canada, all transfers of resources must be authorized by Parliament, the legislature, or council. So, maybe we are just saying that there should not ever be an ED 72 paragraph 91(b) scenario; that is money going out the door that has not been authorized.

In Canada, the transfer <u>must</u> be authorized. Once that occurs (if there are no stipulations or eligibility criteria), the transfer provider has a liability (present obligation) and an expense to provide the transfer(s). The definition of authorization in the Canada standard would indicate when the transfer provider has lost its discretion to avoid the obligation. If that obligation meets the liability definition, that point is when expense recognition would occur.

In discussing the concept of authorization in developing the standard, PSAB concluded that unauthorized transfers were illegal transfers, and the standard should not address accounting for illegal transactions.

Prepayments? We recognize that it is possible that a transfer might be paid after it has been authorized but before it is due, for example before relevant eligibility criteria have been met. And paragraph AG 95 addresses this situation:

> AG95. A transfer provider usually ceases to control the resources it has agreed to transfer at the point it transfers those resources to the transfer recipient. However, in some circumstances, a transfer provider may retain control of the resources until a later date. For example, a transfer provider may make a prepayment, but be entitled to a refund of the prepayment on demand prior to the point at which the transfer provider has a present obligation to make the payment. In such circumstances, the transfer provider retains control of the resources. Consequently, the transfer provider does not derecognize the resources, nor recognize an expense, prior to the point at which it has a present obligation to transfer those resources. Where cash has been transferred, the transfer provider may reclassify the asset as a prepayment.

<u>Suggestion:</u> We encourage the IPSASB to also consider the Canadian guidance relating to one such example in "Shared Cost Agreements: Reimbursement versus Financing Arrangements" in Appendix B to GOVERNMENT TRANSFERS, Section PS 3410.

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?

PSAB Staff Response

Yes. This lack of symmetry is appropriate. And it is consistent with the approach in Canada.

Under Canadian GAAP, GOVERNMENT TRANSFERS, paragraph PS 3410.09, states:

> This Section does not require symmetrical accounting by the transferor and recipient of a government transfer. Symmetrical accounting by the parties to a transaction is not a fundamental principle of accounting theory. In some cases, when it reflects the substance of the transaction for all parties to a transfer, symmetrical accounting will result. In others, the evidence available to support recognition or the ability to estimate the transfer may vary between the transferor and recipient and symmetrical accounting will not occur.

The lack of provider-recipient symmetry is not a disadvantage; just as provider-recipient symmetry is not an advantage. Symmetry either exists and reflects the economic substance of the arrangement; or it does not. Forced symmetry may not reflect the economic substance of the transaction and/or the evidence available to support recognition for each party.

We note, however, that in asserting that a transfer provider has an asset when a transfer recipient has a performance obligation, the IPSASB is in fact forcing symmetry in some of the recognition requirements of ED 72. Paragraph BC 22 notes:

> BC22. If the transfer provider were to recognize an expense as the transfer recipient satisfied its performance obligations, it follows that the transfer provider should not recognize an expense at the point it recognizes the liability, but a corresponding asset. The IPSASB, therefore, considered the nature of that asset.

This text would seem to suggest that effort was required to identify the asset given the conclusion that expense recognition by the transfer provider should occur as the transfer recipient satisfies its performance obligation and recognizes revenue. Once it was decided that the PSPOA would be flipped and also used for expenses, then identification of "the asset" became necessary.

We encourage the IPSASB to consider whether forced symmetry in part of the standard and possibly no symmetry because of other provisions in the standard is appropriate, as it does impair the internal theoretical consistency of the standard. However, we recognize that theoretical purity is not always possible and that pragmatic decisions in standard setting may sometimes be made in order to:

(i) move accounting practice in the right direction,

(ii) reduce complexity for financial statement readers (while still reflecting economic substance), or

(iii) not impose a significant reporting burden on preparers, especially if the additional work will not provide measurable improvements in accountability to financial statement readers.

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?

PSAB Staff Response

Yes. We agree. This approach is appropriate as it recognizes, at least in Canada, the supremacy of Parliament (or the legislature or council), while also acknowledging that a transferor may have a liability to provide a transfer before it has given itself permission to settle the liability (the appropriation).

The approach in ED 72 to the role of appropriations in authorizing a transfer (without performance obligations) seems comparable to that in Canada. In particular, the application guidance in paragraphs AG100-102 includes content similar to that in GOVERNMENT TRANSFERS, Section PS 3410. It is important to retain this guidance in the final IPSAS as it accurately and fulsomely reflects the substance of the diversity of transfer arrangements and how they are authorized in different countries.

In particular, ED 72 states:

> Transfer Expenses without Performance Obligations Subject to Appropriations
>
> 98. Where a binding arrangement specifies that the resources to be transferred to a transfer recipient by a transfer provider are subject to an appropriation being authorized, the transfer provider considers substance over form in determining whether it has a present obligation to transfer the resources prior to the appropriation being authorized.
>
> 99. This limitation (that the resources to be transferred are subject to the appropriation being authorized) does not have substance where the transfer recipient can establish an enforceable right to those resources (and as a consequence the transfer provider has a present obligation to transfer

> the resources) before the appropriation is authorized. Paragraphs AG98–AG102 provide additional guidance on appropriations.

And further in the Application Guidance, ED 72 states:

> AG100. In some jurisdictions [such as Canada – emphasis added], the authorization for a transfer of resources may go through a multiple step process. For example:
>
> (a) The enabling authority to provide a transfer is in place, which is conveyed through approved legislation, regulations or by-laws of the transfer provider;
>
> (b) The exercise of that authority has occurred. In essence, the transfer provider has taken a decision under the approved enabling authority that clearly demonstrates that a transfer recipient has an enforceable right to the transfer of the promised resources, and consequently the transfer provider has lost its discretion to avoid proceeding with the transfer, for example through entering into a binding arrangement; and
>
> (c) The authority to pay is evidenced by the authorization of an appropriation.
>
> AG101. The enabling authority, together with the exercise of that authority, may be sufficient for a transfer provider to conclude that the transfer recipient has an enforceable right to those resources, and that the transfer provider consequently has a present obligation to transfer the resources, prior to the authorization of the appropriation. In such circumstances, the limitation (that the future transfer is subject to the appropriation being authorized) does not have substance, and the transfer provider recognizes a liability and an expense for future transfers prior to the appropriation being authorized.
>
> AG102. In other cases, the authorization of the appropriation may determine when a transfer provider has lost its discretion to avoid proceeding with a transfer. In such circumstances, the limitation (that the future transfer is subject to the appropriation being authorized) has substance, and the transfer provider shall not recognize a liability and an expense for the transfer prior to the appropriation being authorized.

Related Illustrative Example (IE) 35 is probably a bit too black and white. More judgment is required in practice and the cases in IE 35 seem to represent ends of a spectrum.

<u>Suggestion:</u> Perhaps a more "in-between" example is needed? And also, we suggest that guidance for applying substance over form in such circumstances would help. You may wish to consider the discussions of Canada's Public Sector Accounting Discussion Group (PSA DG) on the "authority to pay". The relevant meeting reports can be found here; we suggest searching "authority to pay": https://www.frascanada.ca/en/psab/committees/psadg/search-past-topics . This issue was discussed on September 5, 2013 and March 15, 2017.

A possible example to consider:

- Large multi-year funding arrangements and project payouts, appropriation clause to be voted before paid.

- Construction period is five years, but payment is over 20 years.

  Would the length of the funding agreement versus the construction period make a difference in the accounting? Would an entity recognize the transfer expense over 20 years even though the project is finished in five years?

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?

PSAB Staff Response

Even if the IPSASB continues to use the PSPOA for transfer expenses, we are concerned about the extent of the disclosures proposed. We are not convinced that the complexity of this approach is appropriate for and represents the substance of transfer expenses. In addition to our comments in the covering letter, the extensive disclosure requirements are another reason for concern, as is the resulting complexity in record keeping and reporting.

ED 72 contains significant disclosure requirements. We recognize that they are based on the disclosures in IFRS 15 and those in ED 70. And there is a concern that public sector disclosures should perhaps not be less than those in the private sector.

Considering the extent of disclosures is also an issue in Canada. Extensive disclosure requirements can significantly expand the size of the notes and schedules that accompany the financial statements. This can impair the understandability of financial statements; the notes may not even be read if they are too long or complicated.

Perhaps the proposed disclosures in ED 72 could be condensed and re-organized through consideration of the concepts in Chapter 8 of the IPSASB conceptual framework. And any work done to pare down and re-organize the disclosures for transfer expenses, could then be extrapolated to the disclosures being proposed for revenue in EDs 70 and 71.

APPENDIX B – OTHER ISSUES

1. Necessary definitions are in other EDs:

Issue: Definitions necessary to understand and apply ED 72 are not all in ED 72.

Explanation: Paragraph 9 of ED 72 references definitions that are integral to applying ED 72 that are contained in other EDs, indicating that they are applied with the same meaning in all EDs. We understand that IPSASB stakeholders were being given a lot of pages to review in the three EDs 70, 71 and 72. So, for ED purposes, when all three standards are out for comment together, it probably makes sense that the definitions were only included in one place but relate to all three EDs.

However, this approach may not be appropriate once the standards are issued. This approach would require a reader to keep flipping between three IPSAS in order to interpret each one. If definitions are crucial to understanding and applying a standard, then they need to be in that standard. Alternatively, all definitions could just be in the Glossary to the IPSAS as a whole; but this still would require flipping back and forth by the reader unless the electronic version of the IPSAS makes it easy to move to and from a glossary.

If considering the merits of a new way of electronically publishing the IPSAS, we suggest that interactivity of the Glossary with the individual IPSAS should be a consideration. For example, terms defined in the Glossary could be bolded and accessible by right clicking on the term within the individual IPSAS if that functionality is possible.

2. Issues with "Control of an asset" definition

ED Reference: ED 70 paragraph 7 (Definition of "control of an asset" in ED 70 applies also to ED 72)

<u>Control of an asset</u> is the ability to direct the use of and obtain substantially all of the remaining economic benefits or service potential from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the economic benefits or service potential from, the asset.

(a) Is this definition in ED 70 consistent with the explanation of control in relation to the definition of an asset in the conceptual framework? Paragraph 5.11 indicates:

> [...] Control of the resource entails the ability of the entity to direct other parties on the use of a resource so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.

(b) A definition of "control of an asset" already exists in IPSAS 23. PSAB staff have historically had an issue with this definition. And this definition is amended but retained in its essence in ED 70. The definition of "control of an asset" seems to expand the definition of an asset to include spending on items/matters that the government/entity can benefit from in the pursuit of its objectives, not just items that have future economic benefit or service potential to the government/entity. The definition of "control of an asset" would seem to broaden the idea of the benefit inherent in an asset to include not only future economic benefits in the form of future net cash inflows or future service potential, but also include spending where the government benefits from the spending "in pursuit of its objectives". This broadening of the asset definition could sweep in many types of government spending as assets. This result may not be the intent of the IPSASB, but the wording of the definition opens the door. The Basis for Conclusions notes:

> BC28. In a transfer expense, the transfer provider provides resources to the transfer recipient to deliver goods or services to third-party beneficiaries (service recipients). The IPSASB considered whether the right to have goods or services transferred to the specified third parties satisfies the definition of a resource as "an item with service potential or the ability to generate economic benefits." The IPSASB concluded that, as the goods or services being transferred will allow the transfer provider to meet its objectives, the right to have goods or services transferred to the specified third parties will satisfy the definition of a resource as that right will be an item with service potential.

Does this also expand the notion of what comprises "service potential"?

(c) The definition of "control of an asset" seems to have been amended slightly. It is not clear if a change in substance is intended. Please see table below.

IPSAS 23	ED 70	Conceptual Framework paragraph 5.11
Control of an asset: Arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives, and can exclude or otherwise regulate the access of others to that benefit	Control of an asset: The ability to direct the use of and obtain substantially all of the remaining economic benefits or service potential from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the economic benefits or service potential from, the asset.	Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.

One definition should be used consistently in the IPSAS. This definition should be in the conceptual framework explicitly if it will be operationalized in individual IPSAS. The implications of this definition should also be explained in the conceptual framework.

3. "Binding arrangement asset" is a "Temporary asset":

ED Reference:

ED 72 paragraph AG 6 is confusing. It states:

> AG6. This [draft] Standard defines a transfer expense as an expense arising from a transaction, other than taxes, in which an entity (the transfer provider) provides a good or service to another entity (the transfer recipient, which may be a public sector entity, a not-for-profit organization, an individual or another entity) without directly receiving any good or service in return. For the purposes of determining whether the entity has received a good or service, a transfer provider's binding arrangement asset is not considered to be an asset received by the transfer provider. This is because a transfer provider's binding arrangement asset is the right to have a good or service transferred to a third-party beneficiary. This is a temporary asset that will be derecognized as the transfer recipient fulfils its performance obligations.

Issues:

What is a "temporary asset"? We suggest more information is needed about what temporary assets are and why they are "temporary. For example:

- Are temporary assets a subset of "current assets"? Would use of this term be confused with working capital concepts?
- Are temporary assets restricted to only "binding arrangement assets"?
- A performance obligation may be satisfied over many accounting periods. Would the transfer provider's asset in relation to the unfulfilled performance obligation of the recipient still be "temporary" in such cases?
- Temporary versus permanent are temporal distinctions referring to how long something will exist. Is this the distinction that needs to be made with respect to a binding arrangement asset?

4. Use of term "expenditure"

ED Reference: ED 72, paragraph 1 states:

> The objective of this [draft] Standard is to establish the principles that an entity (a transfer provider) shall apply to report useful information to users of financial statements about the nature, amount, timing and uncertainty of expenditure and cash flows arising from transfer expenses.

Issue: Why is the word "expenditure" used rather than "expense"?

Suggestion: Consider instead: "expenses or expenditures and cash flows" to be more inclusive of all possible elements that may be affected by a transfer for a transfer provider.

5. Scoping in Other Non-Contractual Payables:

ED Reference: ED 72, paragraph 4 states:

> An entity shall also apply this [draft] Standard in accounting for the subsequent measurement of other non-contractual payables, except where the subsequent measurement of the payable is within the scope of another Standard. This [draft] Standard does not apply to the recognition and initial measurement of other non-contractual payables.

Issue: Awkward Scope-In

- This is an odd scope in, even if the principles for subsequent measurement are identical.
- Would an entity look in this standard for such subsequent measurement principles?
- Seems to scope in things that would otherwise meet the transfer expense definition based on ED 72 paragraph 120. Examples of these would help to understand why they are in this standard.
- Changing the title to include “and Subsequent Measurement of Non-Contractual Payables” would complicate the title and overemphasize the extent to which the issue is addressed in the standard.

Suggestion: Find another location for principles relating to subsequent measurement of non-contractual payables. Perhaps a short additional IPSAS that refers to where initial recognition and measurement of these are addressed and includes references to other standards that address specific types of non-contractual payables?

An objective of this would be to ensure that it is easy to find and apply IPSAS on specific topics.

APPENDIX C – Canadian Comparison & Implications

Section PS 3410, *Government Transfers*, provides standards how to account for and report government transfers from both a transferring government and recipient government perspective. However, there are two main differences between the proposed ED 72 and Section PS 3410:

- Scope of ED 72 is different as it covers only the transfer provider accounting.
- Approach – performance obligation approach (ED 72) vs authorization, eligibility criteria and stipulations approach (Section PS 3410).

The differences in approach may result in some differences in recognition and measurement.

For example, under ED 72 for transfer expenses with performance obligations the transfer provider would recognize an expense when or as the transfer recipient satisfies a performance obligation by transferring a promised good or service to a third-party beneficiary. Under Section PS 3410, only authorization and eligibility criteria would be considered in determining the timing of expense recognition by the transferor. Section PS 3410 does not look to whether the good or service was provided to a third party. Depending on the scenario this approach may result in differences in timing of recognizing the transfer in expenses; that is, earlier expense recognition under Canadian GAAP than would occur under ED 72. Under Canadian GAAP, only a breach of the transfer terms would give rise to an asset of the transfer provider - at the time of the breach, assuming that the breach requires the recipient to return transferred resources to the transfer provider

Further, under ED 72 proposals the transfer provider may record a temporary asset if the transfer provider has a present obligation to transfer resources to the recipient before the recipient transfers resources to the third party. Under Section PS 3410 a transfer provider would not record any asset. "This view is based on the fact that the transferring government does not receive economic value in return that can be recognized as an asset. A transfer is a non-exchange transaction and a redistribution of economic resources."[1]

PSAB staff is of the view that the approach proposed in ED 72 is generally more complicated and may be more onerous for public sector entities should it be adopted in Canada in the future, depending on the nature and complexity of the transfer terms.

[1] Section PS 3410, Basis for Conclusions, paragraph 7.