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International Public Sector Accounting Board
529 Fifth Avenue
New York, NY 10017

Our response to Exposure Draft 72: Transfer Expenses is below.

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?

Yes, we agree that the scope of the proposed standard is clear.

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?

No, we do not support this distinction. We do not see value in mirroring the treatment of ED 71 in ED 72. The distinction should be between reciprocal transfers in which the counter-party has a performance obligation to the entity (apply ED 70), and non-reciprocal transfers in which the entity receives no assets or services directly back from the counter-party (apply ED 72).

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?

We believe the transfer should be expensed with or without performance obligations. Unless the transfer provider is receiving goods or services in exchange, it is inappropriate to recognize an asset. If goods and services are to be received in return, it would be accounted for under ED 70. Therefore, transfers under ED 72 should be expensed.

In addition, we note that the proposed standard would allow the transfer provider the option of recognizing an asset or of expensing the transfer by simply choosing whether or not to actively monitor. The benefit of the "asset" to the organization may be limited to the ability to defer when to recognize an expense.

Specific Matter for Comment 4:

This [draft] Standard proposes the following recognition and measurement requirements for transfer expenses with performance obligations:

(a) A transfer provider should initially recognize an asset for the right to have a transfer recipient transfer goods and services to third-party beneficiaries; and

(b) A transfer provider should subsequently recognize and measure the expense as the transfer recipient transfers goods and services to third-party beneficiaries, using the public sector performance obligation approach.

The rationale for this decision is set out in paragraphs BC16–BC34.
Do you agree with the recognition and measurement requirements for transfer expenses with performance obligations? If not, how would you recognize and measure transfer expenses with performance obligations?

We do not agree with the recognition of an asset. While there may be a general presumption that the recipient will provide the required goods or services to third parties, these are not assets of the transfer provider. Governments have multiple areas of responsibility that they may discharge directly or through intermediaries. But the fulfillment of these areas of responsibility do not give rise to an asset of the government. Providing health services to make the population healthier is not an investment that the government would consider capitalizing, and expenditures for national security do not give rise to an asset of a more secure nation. While a healthier or more secure nation is beneficial, these are not benefits that meet the required definition of control for the government to recognize them as an asset. An agreement that would require a transfer recipient to advance the transfer provider's interests in these program areas would not give rise to an asset of the transfer provider any more than providing those services directly would.

In an exchange for goods and services, a pre-payment in a purchase agreement will give the purchaser the right to either receive the purchased asset or service, or receive the return of the funds. Either way, the purchaser will receive an asset and can recognize the pre-payment as an asset.

And for a transfer agreement that requires the recipient to either provide services or return the funds, the recipient would recognize a liability as the recipient has no discretion to avoid fulfilling at least one of these obligations. However, if the transfer provider has lost the ability to direct which action the recipient will take, the transfer provider has lost control over the transferred funds (the transfer provider does not have a unilateral right to receive the funds back from the recipient because the recipient can avoid returning the funds by providing the services to third parties). While we can observe that, conceptually, there is some sort of asset for someone as ultimately someone will receive assets or services under the arrangement, no one has a right to ensure that they will receive the benefits directly – so the requisite control over access to the benefits under the agreement would not be met sufficiently to support recognition as asset.

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.

It may be difficult to apply the accounting for transfers with performance obligations where transfers flow through multiple levels of government. For example, a federal government may transfer funds to a state government that must be used to construct/enhance infrastructure. The state level government then transfers the funds to municipalities to be used on specific approved infrastructure projects. Would the federal government recognize an expense when the state level government passes on the funds, or when the actual infrastructure work is carried out by the municipality? Would the federal government recognize revenue as the municipality spent funds on any eligible infrastructure project (as defined in the terms of the federal transfer) or based on the more restrictive eligible expenditures from the state's transfer (to recognize expenses at the same time the state level government recognizes revenue?

The proposals for transfers with performance obligations to third parties will make the budgeting processes of public sector entities more complicated and may reduce accountability. Appropriations are typically close to the cash spending in accordance with democratic principles. Under the proposals the cash paid under the transfer may substantially differ in timing from when the expense is eventually recognized, making it less clear what is being "voted" as expenditures. As well, because the expense recognition is more outside of the control of the transferor and instead in the control of the intermediary, it may be more difficult to budget for these expenses.

The deferral of recognition of expenses for transfers with performance obligations will also present a challenge for accountability of the executive branch of government to a legislative branch for compliance with spending authorities. This is fairly simple when expenditures incurred are represented by either expenses or purchases of capital. But where a transfer expenditure is recognized as an asset, it may not be clear whether the transfer expenditure(s) recorded as assets plus expenses and capital purchases are all within spending authorities. And in subsequent periods as expenses are recognized, some reconciliation may be necessary to clarify which expenses are against the current year's spending limits and which relate to a prior year's spending limit. The deferral of expense may add complexity to the accounting while also undermining accountability.

There also may be some difficulty in separating substantive performance obligations from those that are present only as a matter of form. Restrictions on the use of funding may be added not for the purpose of mitigating risks and ensuring the transfer provider's program objectives are met, but may also serve to manage when expenses are recognized to massage the reported results of the transfer provider. As auditors, we may find it difficult to verify that the appropriate expense amount has been recognized in a transfer provider's financial statements.

For these reasons, and reasons described in Comment 4, we suggest that all transfers be expensed on the same basis as transfers without performance obligations (paragraph 91).

Specific Matter for Comment 6:

This [draft] Standard proposes the following recognition and measurement requirements for transfer expenses without performance obligations:

(a) A transfer provider should recognize transfer expenses without performance obligations at the earlier of the point at which the transfer provider has a present obligation to provide resources, or has lost control of those resources (this proposal is based on the IPSASB's view that any future benefits expected by the transfer provider as a result of the transaction do not meet the definition of an asset); and

(b) A transfer provider should measure transfer expenses without performance obligations at the carrying amount of the resources given up?

Do you agree with the recognition and measurement requirements for transfer expenses without performance obligations?
If not, how would you recognize and measure transfer expenses without performance obligations?

We agree with the proposals except where assets are transferred that are not recognized in the transfer provider's financial statements. For example, a government may have control over public land and natural resources that are not recognized as assets in the financial statements. The carrying value of these "assets" are effectively zero, though they would have value to a transfer recipient. To assist in accountability for the stewardship of public resources, PSAS should consider having these assets transferred at their fair value, rather than carrying cost. The value of the transferred asset could be written up to its fair value (credit revenue), and then expensed at this fair value amount to reflect the value of the transfer.

Specific Matter for Comment 7:

As explained in SMC 6, this [draft] Standard proposes that a transfer provider should recognize transfer expenses without performance obligations at the earlier of the point at which the transfer provider has a present obligation to provide resources, or has lost control of those resources. ED 71, *Revenue without Performance Obligations*, proposes that where a transfer recipient has present obligations that are not performance obligations, it should recognize revenue as it satisfies those present obligations. Consequently, a transfer provider may recognize an expense earlier than a transfer recipient recognizes revenue.
Do you agree that this lack of symmetry is appropriate? If not, why not?

We agree that this lack of symmetry is appropriate. The purpose should be to reflect the underlying economic substance of the transaction from the perspective of each participant rather than to impose some symmetrical accounting.

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?

Yes, we agree with this proposal. While a government may make future transfers subject to approval of an appropriation (as they cannot expend funds without it), the substance of an agreement and other actions and communications of the transfer provider may remove the transfer provider's discretion to avoid making the future transfers.

Greater reference could be made to the actions and communications of the transfer provider outside of the agreement that may leave the transfer provider with little or no realistic alternative to avoid providing the remaining transfers (provide grounds for the recipient to sue to collect the promised funds from government).

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?

As described above, we do not agree with deferral of recognition of expenses for transfers with performance obligations. We suggest it is better accounting if transfers were all expensed when the transfer provider has a present obligation to transfer resources to a recipient and when the transfer provider ceases to control the resources (the accounting proposed for transfers without performance obligation). This simplified approach may better reflect the economic substance, provide better accountability for expenditures against limits on spending authority. It will also allow simpler disclosure requirements around transfer expenses for the period.

Thank you for the opportunity to comment.

Sincerely,

Wayne Morgan, PhD, CPA, CA, CISA
Ian Sneddon, CPA, CA