1 November 2020

Mr Ian Carruthers
Chairman
International Public Sector Accounting Standards Board
529 Fifth Avenue New York, NY 10017 USA
Via online submission: www.ipsasb.org

Dear Ian

Submission on IPSASB Exposure Draft 72 *Transfer Expenses*

As the representatives of over 200,000 professional accountants in Australia, Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia thank you for the opportunity to comment on the above exposure draft (ED 72).

CA ANZ and CPA Australia welcome the consultation that takes significant strides towards establishing improved recognition, measurement, presentation and disclosure requirements for revenue recognition and transfer expenses in the public sector. Transfer expenses are a critical area for public sector accountability, particularly given the non-reciprocal nature of such transactions and the involvement of public funds and/or donations. This is a complex area and the nuances and details are pivotal to achieving the ultimate objectives of better accountability and transparency.

We have reservations in relation to the current approach taken in ED 72 with respect to definition and scope, recognition, measurement and disclosure of transfer expenses. Particularly, there is a lack of definition and guidance around the term "monitoring" as referred to in the Public Sector Performance Obligation Approach (PSPOA). We are of the view that the proposals require substantial further consideration and development to meet the objectives of providing relevant and useful information through improvements to the statement of income, statement of financial position and associated disclosures. We have provided suggestions in respect of the matters we have identified in our responses to the questions in ED 72 in the **Attachment** to this letter.

If you have any questions about our submission, please contact either Amir Ghandar (CA ANZ) amir.ghandar@charteredaccountantsanz.com or Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au.

Yours sincerely

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Attachment

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?

We do not agree that the scope of ED 72 is clear. We have considered the scope of ED 72 as detailed in paragraphs 3 to 7 and AG4 to AG5 and note the following issues for further consideration by the IPSASB:

- We suggest providing further Application Guidance and Illustrative Examples on how to apply Paragraph 7. Paragraphs AG4-AG5 do not provide additional guidance on how to apply Paragraph 7, while Illustrative Example 3 (IE 3) is provided to assist with the application of this paragraph. However, IE 3 refers to the purchase of two vehicles as a "binding arrangement" and how the vehicle retained by the transfer provider for own use is outside the scope of ED 72, whilst the vehicle transferred to a transfer recipient is within the scope of ED 72. We do not believe this example deals with a binding arrangement with multiple components (that requires application of other Standards) between a transfer provider and transfer recipient.
- Paragraph 5 lists the standards scoped out but neither IPSAS 19 *Provisions, Contingent Liabilities and Contingent* Assets nor IPSAS 32 *Service Concession Arrangements: Grantor* is considered as part of the scope of the ED. We believe there should be more clarity between the scope of this ED and the requirements in IPSAS 19 and IPSAS 32, including consideration of whether IPSAS 19 and IPSAS 32 are scoped in our out of the proposed Standard.
- We note that "capital transfers" are discussed in ED 71 *Revenue without Performance Obligations*. We suggest clarifying the term "capital transfers" referred to in paragraph 3 from a transfer provider's perspective as well.
- It is not clear why the subsequent measurement of other non-contractual payables is brought into the scope of ED 72 through paragraph 4. We suggest clarifying the rationale behind paragraph 4.
- ED 72 proposes to define a transfer expense as "an expense arising from a transaction, other than taxes, in which an entity provides a good, service, or other asset to another entity (which may be an individual) without directly receiving any good, service, or other asset in return." We suggest clarifying the following two points in respect of the proposed definition of transfer expenses:
    - It is not clear whether an expense is a transfer expense if a transfer provider receives any good, service or other assets *indirectly* in return for the provision of transfer expenses, and
    - It would be helpful if application guidance and illustrative examples could be provided to demonstrate how the provision of services could constitute transfer expenses.

- Paragraph 3 states that “Transactions which result in the entity receiving goods, services or other assets directly in return for the resources the entity transfers to the counterparty do not satisfy the definition of a transfer expense and are outside the scope of this [draft] Standard.” Paragraphs 69-71 address the proposed requirements for “Consideration Receivable by a Transfer Provider” which appears to be scoped out of the ED in paragraph 3. We seek clarification of this potential inconsistency.

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?

We broadly agree with the proposed distinction between transfer expenses with performance obligations and transfer expenses without performance obligations, subject to our comments in response to Specific Matter for Comment 3 (SMC 3) and SMC 4.

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 agree with the proposal 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. However, we have a number of concerns around the term “monitoring,” as follows.

For binding arrangements that reflect straightforward and simple transactions between the transfer recipient and third-party beneficiaries, the transfer provider may be able to monitor the satisfaction of the transfer recipient’s performance obligations. However, we are not sure the same claim can be made for more complex arrangements that are envisaged in a five-step revenue recognition model (ED 70 *Revenue with Performance Obligations*). Effectively, the transfer provider is expected to monitor and recognise an initial asset and subsequent expenses for transfer expenses applying the five-step revenue recognition model, through the binding arrangement. We presume this will mean the transfer provider will have to have access to the same information available to the transfer recipient to apply the five-step recognition model. We believe the Public Sector Performance Obligation Approach (PSPOA) will be difficult to monitor in many cases where the provider does not have access to relevant information. Feedback we have received from our stakeholders indicates this approach will be very difficult to apply in practice in most circumstances.

We would also appreciate elaboration on what is meant by the term *monitoring*. According to the criterion listed in paragraph 13(d), "a transfer provider accounts for a transfer expense when the transfer provider can identify and monitor the satisfaction of the transfer recipient's performance obligation throughout the duration of the binding arrangement." This suggests that monitoring occurs "throughout" the duration of the binding arrangement. Does this mean that the transfer provider should have access to real-time information as the transfer recipient satisfies its performance obligations? This is likely to be impracticable in most circumstances. Therefore, we suggest providing guidance on what the phrase, "throughout the duration of the binding arrangement" implies.

Monitoring also is likely to be a time- and cost-intensive process. We have raised concerns in this regard, from a practical perspective, in our response to SMC 5.

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 agree in principle with the proposed recognition and measurement requirements for transfer expenses with performance obligations. However, we believe there are likely to be a number of practical challenges associated with the monitoring of such performance obligations. We have highlighted these in our response to SMC 3 above.

A transfer recipient applying the proposed requirements of ED 70 is expected to make a number of estimates and judgements when recognising revenue. Arguably, a transfer provider will need to arrive at similar conclusions to the transfer recipient through their monitoring process in respect of such estimates and judgements. We presume there is an expectation that the estimates and judgements that lead to revenue recognition by the transfer recipient should be mirrored by the transfer provider. However, we are concerned that there is no practical method by which it can be established that both the transfer recipient and transfer provider have arrived at the same conclusions in recognising revenue and transfer expenses respectively.

We note that the IPSASB considered whether a "binding arrangement asset" exists in the context of the Conceptual Framework in paragraphs BC21-BC36 of ED 72 and concluded that there is conceptual justification for the existence of an asset. Whilst we acknowledge this analysis, we request clarification be provided in the Basis for Conclusions on a conceptual matter relating to service potential as follows:

- Paragraph BC 28 states that the transfer provider has an asset because it has “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.”
- Presumably, the transfer recipient will also recognise an asset which is the resource received from the transfer provider, and that asset also reflects the service potential to third party beneficiaries.

Although both the transfer provider and the transfer recipient recognise an asset on the basis that it has the service potential, arguably the service potential does not differ between the two parties. We presume the distinction lies in the fact that whilst the transfer provider has control over a right to have goods or services delivered, the transfer recipient has control over the resource itself that will enable it to deliver the goods or services. We request this point be discussed further and clarified in the Basis for Conclusions.

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.

As stated in our responses to SMC 3 and SMC 4 above, we foresee practical challenges arising from the requirement for the transfer provider to “monitor” the satisfaction of the transfer recipient’s performance obligations throughout the duration of the binding arrangement.

We have identified the following practical challenges in relation to monitoring requirements:

- Practical difficulties surrounding the transfer provider’s ability to obtain information about the satisfaction of performance obligations over time for the provision of services, due to the transfer provider not necessarily having ready access to the transfer recipient’s accounting information.
- Delays in preparation of financial statements by the transfer provider due to delays in availability of information arising from the monitoring activities.
- The practicability of monitoring a performance obligation throughout the duration of the binding arrangement in cases where the performance obligation has a significantly long timespan and/or is delivered in a form that is difficult to monitor.
- Auditors of the transfer provider’s financial statements will need to be satisfied with the quality of audit evidence that supports the existence of a binding arrangement asset, which may prove challenging without access to the underlying accounting records that are maintained by the transfer recipient.
- It appears transfer providers can make a choice on how they account for the transfer expenses based on whether or not they want to monitor. This could lead to inconsistencies in application of the proposed requirements. For example, a transfer provider may decide either to monitor, or not monitor, depending on how and when they want the transfer expenses to be recognised in their income statement. Effectively, this could allow transfer providers to apply the proposed requirements in a way that provides them with their desired outcome.

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- Due to the flexibility associated with how an entity can determine whether it can or cannot “monitor” a binding arrangement, this could give rise to inconsistent application of the requirements by a transfer provider for different binding arrangements, and inconsistent application across different transfer providers for similar binding arrangements. We do not believe this will lead to a good public finance management outcome and is likely to lead to a loss of comparability.
- Inaccurate ‘monitoring’ (i.e. not adequately evidence-based) may undermine faithful representation.
- There are cost implications of obtaining and verifying the information and the timely preparation of financial statements.
- Practical difficulties that auditors may encounter in auditing expenses that the transfer provider has recognised under the PSPOA. The information and evidence need to be robust and effectively of the same level of quality as that held by the transfer recipient. This will be expensive and effectively require two parties maintaining the same accounting systems/information for one set of transactions.

The description of the relationship between transfer provider and transfer recipient is similar to that of a grantor and operator in IPSAS 32. Practical challenges may arise around which types of transactions would fall under the requirements in ED 72 (paragraph 13) or within the scope of IPSAS 32.

For transfer expenses with performance obligations, if the transfer provider has not transferred the resources at the point at which recognition requirements for a binding arrangement asset are met, this would give rise to a liability and an asset. When the asset and liability extend over a year, the subsequent measurement is unclear, i.e. whether IPAS 41 *Financial Instruments* (IPSAS 41) is applicable and how that would interact with an impairment test under IPSAS 21 *Impairment of non-cash generating assets* (as required by paragraph 122 and paragraph 132). We note that the subsequent measurement of a liability for a transfer expense *without* performance obligations is proposed to be under IPSAS 41 (paragraph 116).

Paragraph 13 discusses the three parties that are relevant to transfer expenses, i.e. transfer provider, transfer recipient and third-party beneficiaries. AG 22 states that “the third-party beneficiaries in three party arrangements do not have any rights to force the transfer recipient to deliver goods and services because they are not parties to the binding arrangement.” We suggest including reference to AG22 clarifying that “parties” identified in paragraph 13(b) are restricted to the transfer provider and the transfer recipient.

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 generally agree with the proposed approach in paragraph 91. We support the proposed approach to measure the expense at the carrying amount of the resources transferred, when the expense is recognised at the date the resources are transferred to the transfer recipient (paragraph 102).

Paragraph 103 sets out proposed requirements of the measurement of transfer expenses before resources are transferred to the transfer recipient. It states such transfer expenses may include fixed costs, variable costs, or both. We suggest clarifying that such costs should be directly attributable to the specific binding arrangement, i.e. they are incremental costs.

We note that paragraph 114 states that the transfer provider does not revalue non-cash assets before they are derecognised. We question the rationale behind this proposal. For example, if the transfer provider was to transfer a non-current asset (e.g. a building) to a transfer recipient as part of the binding arrangement, the transfer recipient presumably has the ability to revalue the asset in their own accounting records. Arguably, this revalued amount reflects the service potential in the transferred asset. However, the transfer provider is unable to reflect the same value relating to the service potential due to the restriction placed by proposed paragraph 114.

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?

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We agree with the proposal that a transfer provider should recognise 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 recognition principle could lead to a situation where a transfer recipient recognises revenue on a different date to when the transfer provider recognises corresponding expense. Although this would not be mirroring the requirement of ED 71 in the transfer provider's financial statements, asymmetrical recognition can be justified if it represents the substance of the economic phenomenon in the financial statements of the transfer provider and transfer recipient respectively. However, the lack of symmetry may cause challenges in consolidated financial statements and we suggest the IPSASB gives further consideration to this point.

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?

We presume the "substance over form" approach that gives the transfer recipient an "enforceable right" could arise in situations where there are constructive rather than contractual obligations arising for the transfer provider. We suggest including additional guidance/examples on circumstances in which a transfer provider needs to consider substance over legal form, in determining whether it has a present obligation, prior to the appropriate transfer being authorised.

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?

We believe the disclosures are excessive, as the proposed requirements effectively mirror the proposed disclosures in ED 70 and ED 71. We suggest further consideration be given to the rationale behind the proposed disclosures.

Other matters
ED 72 refers to the reporting entity mostly as the "transfer provider" and sometimes interchangeably as "the entity." Given that ED 70 refers to the reporting entity as "the entity" and not the "transfer recipient," and ED 71 refers to the reporting entity as the "transfer recipient," we suggest ED 72 (and ED 70 and 71) makes use of consistent terminology to avoid confusion in application.