



ED72 – TRANSFER EXPENSES

Issued 30 October 2020

ICAEW welcomes the opportunity to comment on *ED72 – Transfer Expenses* published by the International Public Sector Accounting Standards Board (IPSASB), a copy of which is available from this [link](#).

We agree that transfer expenses play an important part in public sector financial reporting and that the IPSAS suite of literature will benefit by having a standard on these transactions.

We support the introduction of a Public Sector Performance Obligating Approach which mirrors the revenue model.

However, our main concern with the current proposals hinges around whether the distinction between performance obligation and present obligation is clear enough. Even though performance obligation is a subset of present obligation, the accounting difference is significant. We recommend that IPSASB consider widening the scope of the Public Sector Performance Obligation Approach.

This response of 30 October 2020 has been prepared by the ICAEW public sector team with support from ICAEW's Public Sector Advisory Group.

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KEY POINTS

Support for introduction of a standard on transfer expenses

1. ICAEW supports the aim of ED72 which is to develop a standard that provides recognition and measurement requirements applicable to providers of transfer expenses. This is an important standard for the public sector given the volume of transactions that fall into this category and is a key difference compared with the private sector.

Use of terminology is inconsistent

2. We do not agree with ED72 using the term performance obligation in a different manner to how it is defined in ED70. We do not agree with paragraph 9 in the ED which states that performance obligations are used in ED72 with the same meaning as in ED70. Please see our response to SMC2 for more detail.

Monitoring of transfer recipient's performance obligation

3. There seems to be an inconsistency between paragraphs 13 (d), which states that a performance obligation has to be monitored for the duration of the binding arrangement, and paragraph 46 which states that in some circumstances a transfer provider may not be able to reliably measure the outcome of a performance obligation.
4. Furthermore, we believe that paragraph 46 provides too much scope for the transfer provider to postpone the recognition of expenditure on the premise that it may be able to monitor the satisfaction of performance obligation at some point in the future. We believe that this area is a weak spot in the standards and open to manipulation which will no doubt need to be reviewed in the near future if left un-amended. Please see our response to SMC3 for more detail.

Distinction between performance obligation and a present obligation

5. As detailed in our response to SMC6, we have reservations about the arguments and logic being applied to the accounting treatment of binding arrangements without performance obligations by the transfer provider, in particular the immediate recognition of expenditure as opposed to the recognition of an asset.
6. In relation to binding arrangements with performance obligations, BC28 argues that the transfer provider recognises an asset since that entity has a right to compel the recipient to transfer goods or services to a third party. The asset relates to the right, not the goods and services themselves, which is a resource with service potential. We struggle to see why the same arguments cannot be made for binding arrangements without performance obligations - where the recipient is compelled to incur eligible expenditure or carry out enforceable activity.
7. The transfer provider, under a binding arrangement, has a right to force the recipient to take action (expenditure or activity) and that right would also have service potential. The binding arrangement infers enforceability rights on both parties meaning that the transfer provider has the means to ensure that the resource is used to achieve the transfer provider's objectives.
8. We recommend that IPSASB review whether the Public Sector Performance Obligation Approach (PSPOA) could be more widely applied than is currently being proposed. The arguments in the BCs, as they currently stand, could easily confuse preparers as to why expenditure can be deferred if goods and services are provided to third parties but

recognised immediately if the recipient has to use any resources received on eligible expenditure or activity.

ANSWERS TO SPECIFIC MATTERS FOR COMMENT (SMC)

SMC 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?

9. We agree that the scope of this standard is clear.

SMC 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?

10. In principle we agree with the distinction between transfer expenses with and without performance obligations.
11. As SCM2 suggests, ED72 is designed to mirror the distinction between transactions with and without performance obligation as per the two revenue standards and shares the same terminology. However, we found the use of the terminology in ED72 somewhat confusing, especially having worked through the EDs in a linear fashion since ED72 uses the defined term performance obligation differently compared with ED70.
12. Public sector performance obligations as per ED 70 are obligations for the transfer recipient to deliver goods or services to the purchaser or a third party. ED 72 uses the same Public sector performance obligations from the transfer payer's point of view but is only scoped to include supplies of goods and services to third parties on behalf of the purchaser. We therefore do not agree with the wording in paragraph 9 of ED72 which states that the terms defined in ED70 are used in ED72 with the same meaning. That is not true regarding performance obligations.
13. The confusion is amplified by making reference to performance obligations in the definition of transaction consideration. On the face of it, a transaction consideration could also be viewed as one where the purchaser receives goods and services. IPSASB should review the definitions and define performance obligation as is applied in ED72 or come up with different terminology to ensure the difference with ED70 is understood.

SMC 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?

14. We agree that if a transfer provider is unable or unwilling to monitor the transfer recipient's satisfaction of its performance obligations then prudence should prevail, and the transaction should be accounted for as a transfer without performance obligations.

15. However, we believe that tensions could arise between paragraph 13 (d), 45 and 46. More specifically, we question whether you can monitor progress of a performance obligation without being able to measure it. It would seem logical that monitoring and measuring progress of performance obligations are synonymous. To monitor the satisfaction of a performance obligation sounds very much like a measurement.
16. Furthermore, paragraph 46 allows the transfer provider to defer the recognition of an expense if the performance obligation cannot be reliably measured but expects to be able to do so at a later date. In our view, paragraph 46 provides too much leeway for the transfer provider to defer the recognition of expenditure and more guidance is required in this area. The expectation of being able to measure the outcome of a transfer recipient's performance obligation at a later date is very judgemental and difficult to challenge (say by auditors). Building in such flexibility to recognising expenditure could lead to inconsistent outcomes.
17. Paragraph 46 seems at odds with paragraph 13 (d) which states that you have to be able to monitor the satisfaction of the performance obligations throughout the duration of the binding arrangement. Paragraph 46 contradicts this, and we therefore believe that further guidance is required to clarify the position. In particular how you assess:
 - a. the likelihood of being able to monitor the satisfaction of performance obligations 'at a later date'; and
 - b. the acceptable length of time where monitoring is not possible at the start of the binding arrangement before the use of the PSPOA becomes untenable.

SMC 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?

18. We agree with the recognition and measurement requirements for transfer expenses with performance obligations.

SMC 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.

19. Apart from the difficulties outlined above in relation to monitoring the satisfaction of the recipient's performance obligations throughout the duration of the binding arrangement (and measuring these), we do not have any further comments.

SMC 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?

Performance obligation/present obligation

- 20. The accounting difference between transactions with a performance obligation and those with a present obligation are profound with earlier recognition of expenditure for transactions with no performance obligations more likely. However, in our opinion, the arguments in the BCs to justify the accounting treatment under each scenario are not consistent and open to challenge.
- 21. Given that performance obligations are a subset of present obligations, making a principles-based argument to differentiate these concepts is challenging and one that this draft standard does not fully achieve in our opinion. The definition of performance obligation originates in ED70 Revenue with performance obligations which in turn is aligned with IFRS. However, having an enforceable right enabling the transfer provider to compel the transfer recipient to perform, such as in the construction of a hospital (para 18 ED71), could also be seen as an obligation to perform by the recipient.
- 22. The illustrative example 34 on page 119 states in paragraph IE182 that the transfer provider does not have a present obligation for the remaining payments as these are conditional on the future performance of the transfer recipient. Given that this example is for transfer expenses without performance obligations, using the word performance is confusing since the recipient doesn't actually have a performance obligation as defined in the standard and underlines the point made in the preceding paragraph.

Conceptual Framework definition of an asset

- 23. It appears that a key distinguishing factor between a performance obligation and a present obligation is the transfer of goods and services to a third party. Under a transfer with performance obligations, the transfer provider can recognise an asset until the recipient carries out the performance which is justified in BC21 – BC34 using the Conceptual Framework. Alternatively, the arguments why the transfer provider should not recognise an asset if only a present obligation exists are explained in BC51 - BC57.
- 24. One key argument for the recognition of an asset under PSPOA is found in BC28 which states that the transfer provider's right to have goods and services transferred to third parties meets the definition of a resource. It is the right to require the transfer recipient to transfer goods or services to third parties that gives rise to a resource as that right will be an item with

service potential since the transfer provider will meet its objectives as the transfer takes place.

25. By contrast, the arguments made in BC52 and BC53 seem to indicate that the transfer of goods and services to a third party is the resource. BC53 also states that even if it were possible to identify a resource (for example, where a binding arrangement requires a transfer recipient to construct an asset), that resource will never be controlled by the transfer provider.
26. In our view, transactions with present obligations could also give rise to an asset for the transfer provider. The enforceable right in the binding arrangement for the transfer recipient to incur eligible expenditure or to carry out enforceable activity could also help the transfer provider meet its objectives and thus be seen as a resource with service potential. It is the right, not the goods or services themselves that is the resource.
27. We also believe that the control argument made in BC31 holds true for transfers with present obligations since these are also underpinned by a binding arrangement, resulting in enforceable rights for both parties. 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.
28. We recommend that IPSASB review whether the PSPOA could not be more widely applied than is currently being proposed for the reasons outlined above. If the transfer expense genuinely represents a right to force the recipient into an action that in turn allows the transferor to meet its objectives, then the PSPOA could be applied.
29. Finally, BC28 is the only paragraph in the draft standard that makes a reference to 'specified third parties'. We don't think that the third party needs to be specified in the binding arrangement and we think that the word 'specified' should be removed as it is not consistent with the rest of the ED.

SMC 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?

30. Symmetry in accounting, whilst helpful for consolidation, is not the primary factor in setting accounting standards. There are many examples in accounting standards where symmetry does not exist, such as in the leasing standard. The lack of symmetry is not a concern.
31. What is more of a concern is whether the accounting treatment for transfer expenses with present obligations is faithfully representative and provides users with reliable and useful information. We believe that there may be circumstances where the transfer provider still has substantial control (substance over form) over the application of the transferred resources, and may be able to withhold or recover resources not applied in accordance with the binding arrangement, especially in relation to multi-year grants. In these instances, the application of the Public Sector Performance Obligation Approach (PSPOA) may be more appropriate. See the response for SMC 6 for more detail.

SMC 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?

32. We broadly agree with the proposals that the transfer provider should consider substance over form when deciding whether a present obligation to transfer funds exists prior to the appropriation being authorised. However, if there is an established practice of refusing appropriation, we would consider that the arrangement could not be binding until the appropriation is approved. We therefore think that more emphasis should be placed on the binding arrangement, which confers enforceable rights and obligations on both parties.
33. In the UK, as in many other jurisdictions, the coronavirus led to a widespread diversion of resources from established programmes into emergency support programmes. Ministerial announcements of various support packages were made almost on a daily basis and there was a great deal of uncertainty. We recommend that IPSASB provide additional guidance on the criteria that preparers should use in applying substance over form when deciding if uncertainties about appropriation are sufficiently pervasive for no present obligation to exist.

SMC 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?***

34. We agree with the disclosure requirements.