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The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
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Per electronic submission

Dear John,

COMMENT ON CONSULTATION PAPER ON *ACCOUNTING FOR REVENUE AND NON-EXCHANGE EXPENSES*

We welcome the opportunity to comment on the Consultation Paper on *Accounting for Revenue and Non-exchange Expenses*. We support the initiative of the IPSASB to address some of the issues raised with the application of IPSAS 23, *Revenue from Non-exchange Transactions (Taxes and Transfers)* and to consider how the latest international thinking on revenue recognition principles could be applied in the public sector.

The views expressed in this letter are those of the Secretariat and not the Accounting Standards Board (Board). In formulating its comments, the Secretariat consulted with a range of stakeholders, including auditors, preparers, consultants, professional bodies, and other interested parties. Our responses to the preliminary views and specific matters for comment are included as Annexure A, while other comments are included as Annexure B to this letter.

We are of the view that the IPSASB should reconsider the interaction between the proposed revenue recognition approaches for the categories of revenue identified in the consultation paper. We have included our comments on this matter as "Other Comment 1" in Annexure B.

We found the consultation paper unclear on the next steps that will be taken based on the preliminary views expressed for category B and C revenue transactions. We would, however, suggest that the IPSASB develop one standard for all transactions with performance obligations, if an approach based on whether a transaction contains a performance obligation is selected.

Board Members: Ms T Coetzer (Chair), Mr B Colyvas, Ms I Lubbe, Mr M Kunene, Mr K Makwetu,
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It is also unclear how an updated IPSAS 23 (presumed to retain the current “exchange”/“non-exchange” approaches) for category A transactions will interact with an approach based on whether a transaction contains a performance obligation for categories B and C transactions. What is specifically unclear is what the scope of the various Standards will be and how information will be presented. Any change in presentation will have a pervasive impact on IPSASs, e.g. IPSAS 1 *Presentation of Financial Statements* which requires the separate presentation and disclosure of information about receivables from exchange and non-exchange transactions.

Please feel free to contact me should you have any queries relating to this letter.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Poggiolini', written in a cursive style.

Jeanine Poggiolini

Technical Director

ANNEXURE A – PRELIMINARY VIEWS AND SPECIFIC MATTERS FOR COMMENT

Preliminary View 1 - Chapter 3 (following paragraph 3.8)

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

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

Do you agree with the IPSASB's Preliminary View 1? If not, please give your reasons.

In principle, we support the view that the IPSASB updates the existing requirements to account for revenue in line with the latest international thinking from IFRS 15. The principle of recognising revenue as performance obligations (promises in a contract with a customer) are satisfied is sound. We believe that this principle will be useful in the public sector to determine how, when and what amount of revenue should be recognised.

We are, however, of the view that due consideration should be given to amendments that may be necessary to the IFRS 15 five-step revenue recognition model to be appropriate for the public sector, even if transactions are on a commercial basis. We are of the view that more extensive changes than terminology modifications, such as replacing “contract” with “binding arrangement”, would be necessary, and suggest that the IPSASB considers the following:

- In IFRS 15, revenue is not recognised unless it is probable that consideration will be received. If this criterion is not met, there is no revenue transaction. If any consideration is received, it will either be deferred until all the performance obligations are met or, alternatively, consideration is recognised when cash is received. In the public sector, entities may not be able to determine upfront that it is probable that consideration will be received, because public sector entities often do not have a choice with whom they transact and do not have information of the counterparty's credit risk. For example, a municipality has an obligation to provide electricity which is provided to all households, businesses, industrial parks and other public sector institutions on a commercial basis, even though some amounts would be uncollectable. We suggest that the IPSASB considers if the consequence of this step in the IFRS 15 model results in appropriate information for users in the public sector.
- Considerations discussed in Chapter 4 of the consultation paper for the Public Sector Performance Obligation Approach (PSPOA) are also relevant for commercial transactions, e.g. guidance may be necessary on determining who the customer is. For example, an entity enters into a tripartite arrangement with a resource provider to construct an infrastructure asset on commercial terms (typical construction contracts currently in the scope of IPSAS 11). Once the asset is completed, the asset is transferred to another entity in terms of the agreement, and is not the property of the resource provider. It may not be clear whether the resource provider or the other entity is the customer.
- It could be difficult to determine when a transaction is on commercial terms and has all the characteristics of an IFRS 15 transaction in the public sector as governments' objectives remain different to the private sector. Even relatively straightforward sale transactions in the public sector may not be on full commercial terms. We believe guidance will be necessary to assist preparers in this regard.

- The private sector has found it difficult to implement IFRS 15 as the standard is complex. Extensive guidance would need to be provided, especially on (a) applying the model where multiple goods and services are provided (i.e. more than one performance obligation) in one contract, (b) how to identify distinct goods and services, and (c) the treatment of variable consideration.
- A significant amount of management judgement is applied in the IFRS 15 model in deciding when and how much revenue is recognised. Sufficient application guidance should be provided to ensure entities apply the principles correctly and do not manipulate the model to achieve a particular outcome. Sufficient disclosure of management judgement is key to ensuring users' needs are met.

We believe it is important to clearly address how the IFRS 15 model will apply to construction contracts currently in the scope of IPSAS 11 (which includes both exchange and non-exchange transactions). The consultation paper appeared to focus on IPSAS 9 transactions. Public sector entities in South Africa frequently construct assets on behalf of other public sector entities, and the application of IPSAS 11 is pervasive across the sector. Construction contracts are an area locally where the private sector has encountered difficulty in implementing IFRS 15. Specifically, the timing of revenue recognition based on how performance obligations are defined in a contract was found problematic. The example below illustrates this issue.

An entity could enter into a contract to deliver a construction service, where construction is undertaken according to the requirements and specifications of the customer, e.g. an entity constructs an administration building for a customer based on the requirements and specifications of the customer. An entity could also enter into a contract to deliver a completed product to a customer, which is built according to its own requirements and specifications without any inputs from the customer, e.g. an entity sells a completed administration building to a customer. For a construction service, revenue is recognised over time, whereas revenue is recognised at a point in time when goods are sold. In IFRS 15, revenue would be recognised as performance obligations in the contract are satisfied, and could be at a point in time, or in specific circumstances over time. It may even cause entities to reconsider how they contract with customers to manipulate the accounting results.

Please refer to our "Other Comment 1" for our comments on the interaction of the various revenue recognition models.

Preliminary View 2 – Chapter 3 (following paragraph 3.9)

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

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

We agree with the IPSASB's Preliminary View 2. However, we believe there are a number of things to consider if an updated IPSAS 23 will be retained.

1. Please refer to our "Other Comment 1" for our views on the interaction of the various revenue recognition models.
2. It would be important for the IPSASB to clearly define a "performance obligation" in the public sector to determine which transactions will fall in this category.

All entities in the public sector have service delivery objectives and are accountable to resource providers, service recipients, and the relevant oversight and governance structures to meet those objectives. This accountability could be through formal mechanisms such as a performance agreement with a minister. One could argue that even operational funding with no conditions or

stipulations, such as transfers, contain performance obligations, as entities are expected to meet their service delivery mandate and objectives.

A distinction that may be useful could be to make it clear that an entity should consider if it has a performance obligation that is clearly linked to a specific transaction. This is different to an entity's overall annual (or longer term) service delivery objectives.

3. We believe it would be important to consider the impact that amendments to IPSAS 23 could have on how an entity classifies and accounts for transactions that were previously regarded as non-exchange and in the scope of IPSAS 23. Some of the transactions that were previously classified as non-exchange and within the scope of IPSAS 23 could have performance obligations, and therefore are outside the scope of the amended IPSAS 23. For example, conditional grants are non-exchange and currently in the scope of IPSAS 23. These grants likely have performance obligations and will be classified as category B transactions per the consultation paper. The IPSASB proposes the PSPOA approach for these transactions going forward, which would result in different accounting requirements.
4. We noted in the consultation paper that there are instances where a step in the PSPOA cannot be applied to a transaction in category B, e.g. the consideration is not clearly linked to the performance obligations in the arrangement. The consultation paper is unclear about how these transactions will be classified, but it is presumed they will be classified as category A transactions. Since these transactions have performance obligations, the IPSASB should consider if an updated IPSASB 23 will result in appropriate revenue recognition for these transactions.

Specific Matter for Comment 1 – Chapter 3 (following paragraph 3.10)

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

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

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

We agree that application issues exist with IPSAS 23, most of which were identified by the IPSASB in the consultation paper.

It would be useful if guidance can be provided on the following matters:

- The impact of legislation on the requirements of the standard when recognising revenue from grants and transfers, for example, legislation could:
 - o Allow government to withhold an entity's allocation if certain activities are not performed, or not performed on time, e.g. administrative functions such as approval of a budget and submission to Parliament were not done on time.
 - o Set a grant framework that is restrictive so that stipulations are only satisfied after all deliverables, including administrative deliverables, have been met. This could result in delayed revenue recognition.
 - o Require entities to surrender surplus funds back to government after each financial year if approval has not been obtained to retain them. Uncertainties exist regarding whether a liability should be recognised at year-end where an entity receives approval to retain the funds; as well

as how the return of surplus funds should be accounted for, i.e. a reduction of revenue as the entity was never entitled to it, or an expense, or something else.

- Require entities to collect all monies owed to government. To hold entities accountable, the requirement in the standard that revenue and receivables are recognised to the extent that the flow of future economic benefits or service potential is probable could be misleading to the users as it does not reflect an entity's legal obligation to collect all monies owed to government. The IPSASB should consider if it would be more appropriate to initially present gross revenue due to government, and reflect uncollectability as a subsequent measurement event of the related receivable, by recognising an impairment loss (refer Preliminary View 8). In IFRS 15, revenue is recognised at the gross amount, unless it is not probable that consideration will be received (refer to comments provided in Preliminary View 1 above). If the IFRS 15 revenue recognition model is adopted for category B and C transactions (refer to Preliminary View 1 and Preliminary View 3), there would be an inconsistency between IPSAS 23 applied for category A transactions, and the IFRS 15 revenue recognition model applied for category B and C transactions.
- Determining when an arrangement contains conditions or restrictions, as it is often unclear in the public sector. It is also often unclear whether an arrangement has a return obligation, for example, the arrangement may determine that assets should be returned to the resource provider without stipulating if this includes unspent cash, or the circumstances when it should be returned. It could also be unclear what the amount of the return obligation is, e.g. is it the whole allocation or only a part thereof. Guidance could be provided that if certain indications of the existence of conditions or restrictions are not observable, revenue should be recognised as if no conditions or restrictions are present.

Preliminary View 3 - Chapter 4 (following paragraph 4.64)

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

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

In principle, we support the view that the IPSASB updates the existing requirements to account for revenue in line with the latest international thinking from IFRS 15, as expressed in Preliminary View 1 above.

We do, however, have reservations about the PSPOA, as a number of uncertainties exist regarding the approach. These uncertainties are included in Specific Matter for Comment 2 below.

It is unclear in the consultation paper if the IPSASB has performed an assessment on whether a PSPOA will resolve the issues experienced under the current exchange / non-exchange model. We are unsure from the information in the consultation paper whether the issues would be resolved, given the uncertainties with the PSPOA included in Specific Matter for Comment 2 below. We recommend that the IPSASB undertakes an assessment, before concluding on this Preliminary View, to ensure a PSPOA will resolve the current issues experienced. We also recommend that the IPSASB considers whether the PSPOA will provide the necessary information for users to hold entities accountable and make decisions, i.e. meet the objectives of financial reporting for the public sector. We are unable to agree or disagree with this Preliminary View with the information currently provided.

A minority view was expressed that the current exchange / non exchange approach is preferred above a PSPOA, as the exchange / non-exchange approach is less complex for the type of transactions included in category B. It was also noted that IFRS 15 (and the PSPOA) is geared for commercial

transactions, which may not provide the correct accounting treatment for the public sector. For example, because performance obligations are often not clearly established in a public sector arrangement, entities may conclude that revenue can only be recognised when all obligations in an arrangement have been fulfilled, resulting in delayed revenue recognition that does not reflect how an entity has performed and earned revenue.

Please also refer to “Other Comment 1” in Annexure B for our views on the interaction of the various revenue recognition models.

Specific Matter for Comment 2 - Chapter 4 (following paragraph 4.64)

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

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

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

Step 3 – Determine the consideration (paragraphs 4.47 – 4.50);

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

Step 5 – Recognise revenue (paragraphs 4.55 – 4.58).

Do you agree with the proposals on how each of the IFRS 15 five-steps could be broadened?

If not, please explain your reasons.

We mostly agree with how the IFRS 15 five-steps have been broadened for the public sector. We include further matters for the IPSASB’s consideration below.

Step 1

Identifying a binding arrangement

Identifying a binding arrangement could be difficult in the public sector as entities may incur rights and obligations similar to a contract through various mechanisms. A clear definition of a binding arrangement and extensive guidance on how it should be identified should be provided.

Clear guidance would need to be provided on determining which documents constitute a binding arrangement so as to identify performance obligations, as this will affect how, when, and how much revenue is recognised. For example, entities could annually be appropriated conditional grants in law, and receive an annual allocation letter from its line Ministry. The allocation letter could set out further conditions and restrictions on the use of the grant, which could be read as performance obligations. The allocation letter is not signed by the entity, nor does the entity have any say in the terms thereof. It is unclear if such letters should be considered a ‘binding arrangement’.

Enforceability of arrangement

We suggest that the enforceability of the arrangement be further explained as it is unclear what should be considered to determine if an arrangement is enforceable. For example, the allocation letter from the line Ministry referred to in the previous paragraph is not signed by both parties, although the entity is expected to comply with its contents.

The phrase “reductions of future funding for the same program” as an enforceability mechanism (paragraph 4.32 of the consultation paper) is unclear and should be clarified. There could be a number

of reasons why there is a reduction in future funding of a program that are not linked to the enforceability of a binding arrangement, for example, government-wide budget cuts.

Parties to the arrangement

We agree with how the parties to the arrangement have been clarified. It may be necessary to clarify how the guidance should be applied to principal-agent arrangements.

Step 2

A clear definition of a performance obligation in the public sector should be provided.

Identifying performance obligations in a binding arrangement could be difficult, especially where more than one performance obligation exists in a binding arrangement. The private sector is establishing principles for certain industries. We are of the view that it would be useful to see if guidance developed in the private sector on identifying performance obligations can be applied by the public sector.

Step 3

Identifying the consideration could be problematic where the agreement is not for a specified amount, but includes variable consideration. The private sector has recognised that variable consideration is both a significant change from the previous model (where consideration was fixed and determinable), and a challenge in the implementation of IFRS 15. This step can be complex as it requires estimation and management judgement.

For example, construction contracts often include penalties or bonuses for late or early finalisation of a project. Industries could also have established practices to give discounts, which should be considered to determine the variable consideration. In the public sector, discounts could even be determined in law or similar means.

Sufficient guidance would need to be provided on how the amount of variable consideration should be identified and calculated.

Step 4

The cost of fulfilment would provide an appropriate basis on which to allocate the consideration. It could, however, be difficult to determine. This is because the cost of fulfilment often consists of various cost elements, some of which may need to be allocated among various activities, and would require management to make estimations. Public sector entities often do not have sophisticated systems to enable them to calculate the cost of fulfilment and may not have all the necessary information available. Sufficient guidance should be provided on what costs should be included and how they should be measured.

Guidance should also be provided on how to allocate consideration where a binding arrangement includes consideration for performance obligations as well as a transfer with no performance obligations. Allocating the consideration between the transfer (category A transaction) and performance obligations (category B or C transaction) could be problematic in the absence of guidance.

Step 5

No specific comments have been noted.

Specific Matter for Comment 3 - Chapter 4 (following paragraph 4.64)

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

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

Please explain your reasons.

We favour **option (b)** that will retain the existing revenue recognition requirements, but will require entities to include additional display or disclosure in the financial statements. This is because only conditions with return obligations have accounting consequences in terms of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. Without a return obligation, an entity can effectively use the resources in any accounting period and for any purpose. Option (b) could provide all the necessary information to the users, while being conceptually sound, and easy and cost effective to implement.

We are, however, of the view that the IPSASB should consider the following when introducing option (b):

1. The statement of financial performance is often presented with a significant number of line items, which can detract from a user's ability to understand the information. For the statement of financial performance to comply with the qualitative characteristics in the Conceptual Framework, we support disclosure in the notes, as proposed in paragraph 4.14(a) and illustrated in paragraph 4.16 of the consultation paper.
2. An entity may have received a large number of grants without conditions where additional disclosure would be required. The IPSASB should consider providing guidance on the level of aggregation at which information should be disclosed.
3. The consultation paper only considered that time requirements as a restriction should be further explained to the users. There could, however, be many other restrictions that an entity would also want to explain to the users through additional disclosure. For example, an entity that receives a grant with no return obligation and no time requirements, but a restriction that the money can only be used to supply services to a certain community. The entity would want to disclose the proportion of the revenue and related number of community members serviced in a year in relation to the total revenue and number of community members to be serviced with the grant, although all the revenue would have been recognised initially. We therefore suggest that entities should be allowed to apply judgement to decide for which restrictions additional information should be disclosed.

In general, we believe that consideration should be given to how users could be better educated about information in the financial statements. For example, when users see an entity has made a surplus in a year, it is assumed the entity is performing well and does not need additional funding. The contrary is true when an entity has made a deficit. A surplus or deficit could, however, be due to a number of factors that do not necessarily reflect an entity's performance, and which are generally not well understood by users. We also acknowledge that accounting requirements will not solve uncertainties that exist where agreements are not clearly drafted. We believe providing information through well drafted accounting policies and disclosure in the notes would go some way in achieving better understanding, which the IPSASB could emphasize in the guidance provided.

We have received the following views relating to the other options:

Options (c) and (d)

Stakeholders were generally uncomfortable with options (c) and (d) and questioned the conceptual correctness thereof and how well users would be able to understand the information presented. Option (d) may be particularly difficult for users to understand as it has not been used before.

Option (e)

Stakeholders were generally not supportive of option (e), because it could result in inappropriate accounting practices that are similar to fund accounting, and it would be difficult for users to understand that a portion of revenue has been recognised in the statement of changes in net assets.

There was, however, a view that option (e) will be suitable as it removes volatility from the statement of financial performance and simplify the accounting treatment.

Specific Matters for Comment 4 - Chapter 4 (following paragraph 4.64)

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

(a) Yes

(b) No

Please explain your reasons.

Yes, we agree that additional guidance on making the exchange / non-exchange distinction should be provided. Applying the definition of exchange transactions, particularly the phrases “directly giving” and “approximately equal value”, is problematic in practice. Additional guidance, including practical examples, would be useful to make the distinction clear.

Preliminary View 4 - Chapter 5 (following paragraph 5.5)

The IPSASB considers that accounting for capital grants should be explicitly addressed within IPSAS.

Do you agree with the IPSASB’s Preliminary View 4? If not please give your reasons.

Yes, we agree that there is currently a lack of guidance on how to account for capital grants and that the IPSASB should address this within IPSASs.

Specific Matters for Comment 5 - Chapter 5 (following paragraph 5.5)

(a) *Has the IPSASB identified the main issues with capital grants?*

If you think that there are other issues with capital grants, please identify them.

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

Please explain your issues and proposals.

(a) Yes, the IPSASB has identified the main issues with capital grants. Capital grants is an area where uneven revenue recognition exists, because:

- Conditions attached to capital grants are often strict and mean that revenue recognition is delayed. E.g. a condition that the grant must be repaid if the completed building does not meet a list of requirements. An approach that better aligns the intended use of the funds with how they were actually utilised would provide better information to the users.

- Conditions could be so lenient that an entity can recognise all revenue upfront before performing the work. E.g. the only condition could be that an entity buys a property on which to construct a building for which the grant is intended. Although some entities view the volatility in their statement of financial performance by recognising all the revenue upfront in one year as a problem, others could welcome it to hide other operating deficits in that particular year. This does not assist users to hold entities accountable. Information would be more useful if it allows a user to compare an entity's capital work-in-progress to the revenue recognised from the grant in that year.
- Expenditure related to capital grants is capitalised and not recognised in the statement of financial performance, which may lead to a surplus in the year(s) that the revenue is recognised.

We furthermore suggest that the IPSASB considers including guidance on distinguishing capital grants that are specifically allocated for capital projects and often with conditions, from general transfers, which may also be used for capital expenditure at the entity's discretion. Because the entity would not have discretion over the use of a specific capital grant with conditions, the appropriate accounting treatment may differ from general transfers where an entity can decide how to use them.

- (b) As capital grants are intended for capital projects, IPSASB could consider a revenue recognition model similar to the model that will be applied to construction contracts.

Specific Matter for Comment 6 – Chapter 5 (following paragraph 5.9)

Do you consider that the IPSASB should:

- (a) *Retain the existing requirements for services in-kind, which permit, but do not require recognition of services in-kind; or*
- (b) *Modify requirements to require services in-kind that meet the definition of an asset to be recognised in the financial statements provided that they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information; or*
- (c) *An alternative approach.*

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

We prefer **option (b)** to modify the existing requirements to require services in-kind to be recognised under certain circumstances, because entities' financial statements could otherwise misrepresent the resources required to fulfil their mandates.

Difficulties with measuring services received in-kind exist, but only recognising those services in-kind that can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information, would result in useful information in the financial statements.

We suggest that the IPSASB considers the following:

- Where services received in-kind do not meet the criteria to be recognised, it may be appropriate to require entities to disclose information about the nature and type of services received in-kind. For example, services received in-kind from international donors, such as humanitarian aid and disaster relief, could be very difficult to quantify given a number of factors that could play a role, including exchange rates and the timing of receipt of the services. It could, however, be significant and important to disclose information regarding the benefits received to users.

- For comparability purposes and to provide sufficient information to users, it may be appropriate to also require disclosure of the nature or type of recognised services received in-kind.
- Based on the approach in (b), there may be certain types of services received in-kind that should be recognised but are not relevant to the entity and would not be of interest to users. The IPSASB could consider introducing further requirements for when to recognise services received in-kind, e.g. when they are significant to an entity's operations or service delivery mandate and objectives.
- We are of the view that it is irrelevant whether an entity would have procured the services if it had not been received in-kind, because the entity has received the benefits. Overlaying an additional requirement, as discussed in the point above, would better reflect to users what resources the entity requires to deliver on its mandate.
- As with any other information in the financial statements, materiality should be considered.

Preliminary View 5 - Chapter 6 (following paragraph 6.37)

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

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

It is not clear what types of non-exchange expenses will be included in universally accessible services and collective services. For example, to provide street lighting, an entity procures infrastructure and electricity. Both these elements are exchange expenses that are recognised in terms of other IPSASs. Similarly, expenses to provide public education would be exchange transactions, such as teacher salaries, learning material, etc.

We are of the view that the IPSASB should re-consider the appropriateness of the guidance proposed in the consultation paper based on the following:

1. If the thinking is that these exchange elements of providing the services should be reclassified from various line-items in the financial statements to a non-exchange expense line-item:
 - These elements are recognised in terms of other IPSASs. There is no need for specific guidance on their recognition. Guidance may need to be provided on the classification.
 - IPSAS 1 *Presentation of Financial Statements* requires that expenses are analysed by nature or function. Re-classifying certain elements from current line items by nature or function to line items specifically for non-exchange expenses could impact compliance with this requirement.
 - It is unclear if entities will be required to separately present exchange and non-exchange expenses. If so, the same difficulties with classifying revenue, as discussed in the consultation paper, will exist for expenditure. One transaction could have elements of both exchange and non-exchange. For example, a public hospital could provide free services and paid services, depending on e.g. a patient's financial status. This would require allocating all hospital expenses between paid and free services, e.g. allocating a doctor's salary based on hours spent on patients who do not pay vs. those who pay, etc.
2. If the non-exchange expenses referred to as universally accessible services and collective services in the consultation paper are:
 - actual non-exchange expenses (we could not identify a specific example), we suggest the IPSASB considers if specific guidance is necessary to account for them.

- cash transfers to other entities to provide these services, or cash transfers to households, we are of the view that these transfers are in the category of expenses included in Preliminary View 7 below, “grants, contributions and other transfers”.

As we are unclear about the types of transactions that the IPSASB proposes should be recognised with this approach, we cannot agree with the Preliminary View. We agree with the principles proposed for the approach, i.e. a liability should be recognised when the criteria in the Conceptual Framework are met, with the related expense; and an entity should recognise an asset if a condition with a return obligation exists, and once the condition is met it will be expensed.

Please refer to our view included in Preliminary View 7. This approach may be appropriate for the transactions included in Preliminary View 7, i.e. grants, contributions and other transfers, although we are unsure about the scope of those transactions.

Preliminary View 6 - Chapter 6 (following paragraph 6.39)

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

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

Yes, we agree with the Preliminary View. Liabilities should be recognised when the definition is met. If there is no obligating event, no liability should be recognised and resources should be expensed as services are delivered.

Preliminary View 7 - Chapter 6 (following paragraph 6.42)

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

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

We are of the view that the PSPOA for non-exchange expenses would not necessarily be appropriate, for the following reasons:

- Please refer to “Other Comment 2” in Annexure B for our comments on the types of non-exchange expenses identified. It is unclear what type of transactions will be included in this Preliminary View.
- Please refer to Specific Matter for Comment 2 where some uncertainties regarding the PSPOA for revenue transactions were expressed. The same uncertainties would exist for non-exchange expense transactions.
- Although a good starting point, mirroring the transactions for resource provider and resource recipient is not necessarily the best information for a user and should not be the only consideration.

For example, when Entity A transfers funds to Entity B for Entity B to deliver goods or services to third parties, and the arrangement is not a principal-agent arrangement, Entity A has funded Entity B. Entity B will recognise exchange expenses in accordance with existing IPSASs to provide the goods or services to third parties as they are incurred, and will recognise the related revenue (transfer from Entity A) in a manner to be determined from this project. Entity A will recognise a non-exchange transfer payment to Entity B, which does not need to reflect when Entity B incurs the exchange expenses to deliver the goods or services. If, however, Entity A procured goods or services from Entity B to deliver to third parties, the nature of what Entity A has procured is

exchange goods or services. This will be recognised in accordance with existing IPSASs by Entity A.

- Guidance for exchange expenses is mostly provided through IPSASs dealing with the statement of financial position. The statement of financial performance is the result of these transactions. It is unclear in which format the IPSASB proposes to provide this guidance, but we suggest that the same approach be followed for non-exchange expenses.

We therefore believe it would be more appropriate to apply the Extended Obligating Event Approach to the transactions included in Preliminary View 7, and not a PSPOA.

A minority view was, however, expressed that a PSPOA for the transactions included in Preliminary View 7 could positively assist to hold entities accountable for grants and other funds they are transferring and could curb fiscal dumping where an entity has not performed in a year.

Preliminary View 8 - Chapter 7 (following paragraph 7.18)

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

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

It is unclear what is meant by "... with any amount expected to be uncollectible identified..." in the consultation paper. It could mean one of three things:

- (a) the gross amount of revenue is initially recognised, with the receivable being recognised at the gross amount less impairment, and a day 1 impairment loss recognised in the statement of financial performance,
- (b) revenue and the related receivable are recognised at the amount net of impairment, or
- (c) revenue and the related receivable are recognised at the gross amount. Any initial impairment is identified, but not recognised. Impairment is re-assessed at year-end and recognised against the receivable and an expense in the statement of financial performance.

It is furthermore unclear if entities should consider uncollectability based on the incurred loss model, or the expected credit loss model (proposed in the IPSASB's Exposure Draft on *Financial Instruments*).

IFRS 15 includes a practical expedient that financial assets that will be collected in less than 12 months need not be discounted. The IPSASB should consider if this practical expedient would also be useful for non-contractual receivables, since they are likely short-term in nature.

We are of the view that revenue (refer Specific Matter for Comment 1) and the related receivable should be recognised at the gross value initially and that uncollectability should be considered as a subsequent measurement event at year-end, i.e. interpretation (c) above.

Preliminary View 9 - Chapter 7 (following paragraph 7.34)

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

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

We do not agree that non-contractual receivables should subsequently be measured at fair value, for the following reasons:

- Receivables from contractual arrangements are not measured at fair value, but are measured at

amortised cost, as proposed in the IPSASB Exposure Draft on *Financial Instruments*. Contractual and non-contractual receivables are similar in nature and the conceptual reason for treating non-contractual receivables differently is unclear.

- Determining a market interest rate would be difficult and entities would not have all the required information, such as market information and the counter party's credit risk. We do not think using a government bond rate would be an appropriate alternative as the government bond market could differ significantly from the market for a non-contractual receivable (which often does not exist) and does not take the risks of the transaction into consideration.
- It would be difficult for a user to understand the movement from the initial measurement model suited for the receivable (refer Preliminary View 8), to a subsequent measurement model that is fair value, because fair value reflects what an instrument is worth in a market and these instruments generally do not have a market. A user would need information about the reasons for the underlying changes in fair value, e.g. changes due to market risk, credit risk, etc.

We are of the view that these receivables should subsequently be measured at amortised cost, because similar financial instruments are measured at amortised cost and these instruments are not substantially different. We are also of the view that these types of receivables would generally be settled within a relatively short period of time.

As an alternative, if determining amortised cost proves too unreliable and difficult for these types of receivables, we are of the view that they could be measured at cost.

Specific Matter for Comment 7 – Chapter 7 (following paragraph 7.46)

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

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

Please explain your reasons.

We prefer **option (a)**. We are of the view that the cost of fulfilment approach would provide the most useful information to the users regarding the value of an entity's non-contractual payables, because it will present the best estimate of the amount required to settle the obligation, and would take time value for money into consideration, if material.

The cost of fulfilment is furthermore likely what entities have been applying in the absence of specific guidance.

Alternatively, measuring non-contractual payables at amortised cost would be in line with the financial instruments they resemble, and because these payables are generally short-term in nature, the effect of discounting may often be negligible.

ANNEXURE B – OTHER COMMENTS

1. Revenue recognition models

Category B and C transactions

It is unclear in the consultation paper how the IPSASB plans to implement the Preliminary View 1, read together with Preliminary View 3. From the IPSASB work programme discussed at the December 2017 meeting, it appears as if two separate standards will be developed: one standard that contains an IFRS 15 five-step revenue recognition model for commercial transactions; and another standard with a similar model modified for the public sector and transactions that do not have all the characteristics of IFRS 15 transactions (the PSPOA).

We are of the view that (a) only one model should be developed for all Category B and C transactions if it is feasible to proceed with the PSPOA, and (b) this should be addressed in one standard. This is because:

- One standard can easily explain the five-step model in IFRS 15, with additional guidance on each of the five steps where not all of the characteristics of an IFRS 15 transaction exist (the guidance currently included for the PSPOA).
- Applying the PSPOA to “commercial transactions” in the public sector would likely render the same answer as applying the pure IFRS 15 model. It is also likely that there are not many transactions in the public sector that meet all the characteristics of an IFRS 15 transaction. There is therefore no need for two separate models or two separate standards.
- A number of complexities exist with the IFRS 15 model in each of the steps. Extensive guidance on the application of the model would need to be provided twice if two separate standards are developed.
- There would be significant duplication of content if two separate standards are developed.
- It would be difficult to establish within which standard a transaction falls as the distinguishing factors between the purely commercial public sector transactions and those that do not have all the characteristics of IFRS 15 transactions have not been established and would likely be a “grey area”.
- There is a general lack of resources, such as skills and financial means, available in the public sector. The model should be as easily understandable and implementable as possible. Having two standards with a similar model; or even two similar models in one standard, would unnecessarily complicate the accounting treatment and detract from the usability of the standards.

It is also unclear from the consultation paper where an entity should start to categorise transactions. E.g. is it a cascading model where an entity first assesses a transaction against IFRS 15? If it does not meet all the characteristics, does an entity apply the PSPOA? If a step in the PSPOA cannot be applied, because the transaction does not have the characteristics required, is the transaction in category A?

Classification of revenue transactions as Exchange / Non-exchange vs. Performance Obligations

It is unclear from Preliminary View 1, Specific Matter for Comment 1, Preliminary View 2 and Preliminary View 3 how the IPSASB envisages the various models will work together.

If Preliminary View 2 is retained and IPSAS 23 is updated for Category A transactions, does it mean that the current exchange / non-exchange model partially remains (as it is the basis for IPSAS 23), and this is then applied together with a model based on performance obligations for Category B and C transactions (as outlined in Preliminary View 1 and Preliminary View 3)?

We foresee that this will cause a number of difficulties, particularly with determining in which category transactions fall. Although the categories have briefly been described in the consultation paper, there could be a number of transactions that currently do not clearly fall in a specific category, while some may fall in more than one category. For example, licenses and permits:

- They could be seen as being provided on commercial terms, especially when predominantly provided to the private sector.
- They are often provided with conditions and other stipulations on the license holder and there could also be performance obligations for the issuer of the license.
- There is an argument that it could be a tax as the license holder does not have a choice in procuring it.
- There could be various ways to recognise the revenue, e.g. immediately, or over the period of use or right granted, which would be determined by the classification of the item.

We are therefore of the view that the IPSASB should decide to use either the exchange / non-exchange model, or a model based on performance obligations, and use it consistently across all categories of revenue. The categories should also be clearly described, with extensive principle-based guidance on how to classify transactions. Otherwise the same difficulties expressed with classifying transactions as either exchange / non-exchange, will remain with determining whether an entity has performance obligations or not.

The IPSASB should also consider how a performance obligation approach for categories B and C transactions would interact with the Government Finance Statistics (GFS). The GFS requires information about which transactions are exchange and non-exchange. It is unclear how this GFS need will be met if an exchange / non-exchange model is replaced with a model based on performance obligations. It may result in entities being required to have information for both models available. This has not been considered in the consultation paper.

2. Types of non-exchange expenses

We are of the view that the consultation paper does not address all types of non-exchange expenses that were not excluded from the scope of the consultation paper.

The consultation paper includes in its scope (par. 6.2):

- (a) Collective services
- (b) Universally accessible services; and
- (c) Grants, contributions, and other transfers (including services in-kind)

It is unclear in which category non-exchange expenses such as taxes (other than income taxes), fines and penalties payable will fall and what the IPSASB's views are on recognising them. There are also other types of non-exchange expenses not currently dealt with in the consultation paper, such as debt forgiveness.

The IPSASB's Preliminary View 5 is that (a) and (b) should be recognised using the Extended Obligating Event Approach. Preliminary View 6 is that (c) should be recognised using the PSPOA. It is also unclear how (c) transactions should be recognised where the PSPOA cannot be applied, because the transaction does not have the characteristics required in the model.

We are of the view that the IPSASB should first consider if guidance is necessary for non-exchange expenses, and if so, to what extent. Guidance already exists in the conceptual framework and the

guidance that exists for exchange expenses, mostly through IPSASs dealing with statement of financial position items, could be applied to non-exchange expenses by analogy. If guidance is required, it may not be necessary to develop an IPSAS, but could be included in existing IPSASs.

3. Timing of guidance

The IASB has issued IFRS 15 on 28 May 2014 and it applies to an entity's first annual IFRS financial statements for a period beginning on or after 1 January 2018.

Locally, challenges are being identified and questions are being asked about how the standard should be applied as entities are preparing to implement IFRS 15.

The IASB has furthermore issued IFRS 9 on *Financial Instruments* on 24 July 2014, with an effective date for annual periods beginning on or after 1 January 2018. There is a significant relationship between IFRS 15 and IFRS 9.

We are of the view that it would be appropriate for the IPSASB to allow sufficient time before finalising guidance on revenue to learn lessons from the private sector, specifically regarding the implementation of IFRS 15. As much as we agree that guidance should not be unnecessarily delayed, given the difficulties already expressed in the private sector with IFRS 15, it may be premature of the IPSASB to finalise and issue guidance that could have been improved if these lessons and possible improvements to IFRS 15 are taken into consideration.

4. Inclusion of application guidance and examples

Given the difficulties experienced by entities in practice to account for revenue and non-exchange expenses, we are of the view that it would assist if extensive application guidance and examples are included in any guidance developed as an outcome of this consultation paper.