NZ ACCOUNTING STANDARDS BOARD

EXTERNAL REPORTING BOARD

Te Kāwai Ārahi Pūrongo Mōwaho

NOTE: Wi-Fi Access Code:
Network name: XRB_GUEST
Access code: kq4mnlxd
(lower case 'L' not figure 1)

Board Meeting Agenda

Thursday 14 December 2017
External Reporting Board, Level 7, 50 Manners Street, Wellington

LATE PAPERS

Est Time	Item	Topic	Objective		Page
A: NON-PUBLIC SESSION					
Preliminary					
9.20 am	**2**	**Board Management**			
B: PUBLIC SESSION					
PBE Item for Approval					
9.50 am	**3**	**Revenue and Non-Exchange Expenses**	(AH/ALH)		
	3.1	Cover Memo	Consider	Late paper	
	3.2	Draft Comment Letter	Consider	Late paper	
	3.3	Submissions Received			
	3.3.1	Broadcasting Commission (NZ On Air)	Note	Late Paper	
	3.3.2	BDO	Note	Late Paper	
	3.3.3	NZ Film Commission	Note	Late Paper	
	3.3.4	Auckland Council	Note	Late Paper	
	3.3.5	Te Māngai Pāho	Note	Late Paper	
	3.3.6	Audit NZ	Note	Late Paper	
	3.4	IPSASB CP *Accounting for Revenue and Non-Exchange Expenses*	Note	See website	
10.30 am		*Morning tea*			
10.45 am	**3**	**Revenue and Non-Exchange Expenses (contd)**	(AH/ALH)		

Next NZASB meeting: Wednesday 7 February 2018

197256.1

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

Memorandum

Date:	7 December 2017
To:	NZASB Members
From:	Aimy Luu Huynh and Anthony Heffernan
Subject:	**IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses***

Purpose and introduction[1]

1. The purpose of this paper is to seek the Board's approval of the draft comment letter on the IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (the CP).

2. The Board met on 24 November to discuss and provide feedback on the draft comment letter and to consider the Working Group's feedback.

3. The IPSASB published the CP in August. Comments to the NZASB closed on 22 November 2017. Comments to the IPSASB are due by 15 January 2018.

4. An updated and complete draft comment letter is provided as agenda item 3.2. The draft comment letter includes feedback from the last Board meeting and last Working Group meeting.

5. The NZASB's proposed framework for the recognition of expenses, diagram 2 in the draft comment letter, has been updated since the last Board meeting. The Board's draft response on non-exchange expenses is based on this diagram. If Board members have any feedback on the diagram which could change the direction of the draft comment letter, please provide comments to staff (aimy.luuhuynh@xrb.govt.nz) prior to the Board meeting.

Summary of staff recommendations

6. We recommend that the Board:

   (a) CONSIDERS the submissions received on the CP;

   (b) APPROVES the draft comment letter on IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* subject to any changes agreed at the meeting; and

   (c) AGREES the process for finalising the comment letter.

[1] This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

Structure of the memo

7. The remainder of this memo is set out as follows:

   (a) Submissions received;

   (b) Next steps;

   (c) Appendix 1: Summary of the Board's views; and

   (d) Appendix 2: Respondents' comments and staff response.

Submissions received

8. Comments were received from the following seven respondents.

Respondent #	Respondent	Agenda item
R1	Broadcasting Commission (NZ On Air)	3.3.1
R2	BDO New Zealand Limited	3.3.2
R3	New Zealand Film Commission	3.3.3
R4	Auckland Council	3.3.4
R5	Te Māngai Pāho	3.3.5
R6	Confidential	2.3.5
R7	Audit NZ	3.3.6

9. R1, R3 and R5 (public sector grantors) had consulted each other on their submissions and shared common concerns about the CP's proposed accounting for non-exchange expenses. The public sector grantors have provided comments on non-exchange expenses only. We have analysed their comments as one group, public sector grantors. R1 has informed us that they have provided the same submission to the IPSASB.

10. Appendix 2 to this memo provides an analysis of R2, R4, R6 and R7's comments and staff's response. A summary of these respondents' comments is provided below.

Public sector grantors' comments

11. R1, R3 and R5 are public sector entities. They receive funding mainly from the government and/or grants from other public sector entities. Their main expenditure is grants.

12. The grant expense accounting policies for the public sector grantors are broadly consistent. They recognise the grant expense and liability when the grant has been approved by their respective boards, communicated to the recipient and has been accepted by the recipient. R5 noted that acceptance by the recipient is the obligating event and at this point the recipient has a valid expectation that they will receive the full funding. R1 noted that when the funding is approved, the recipients have a valid expectation they will receive the funding.

13. R3 noted its accounting treatment reflects the funds are ring-fenced for a particular project and prevents the funds from being utilised elsewhere. R1 does not think it is appropriate to report the funding expenditure over the period of the payments because once the resources are allocated they are no longer available to the respondent (R1) for any other purpose.

14. Some of the grants have milestones which are linked to the payment of the grant. R1 considered the milestones to be more of an administrative matter to manage the cash flow of the recipients. They have not considered these to be substantive conditions. R5 considered these to be administrative milestones. Based on the public sector grantors' interpretation of performance obligations and obligating event in the CP, they considered milestones and instalment payments to be performance obligations and obligating events and would result in the deferral of expenses.

15. The public sector grantors are broadly supportive of the Public Sector Performance Obligation Approach (PSPOA) but have concerns with the proposal to defer the recognition of grant expense. They all have the following quote in their submission:

    We share common concerns about the continuing ability to present financial statements which are meaningful, useful to our users and reflect the underlying reality of our funding expenditure. Many of our interested stakeholders are the same, and comparability both between years and between entities is important. Our financial statements only provide a true reflection of funding expenditure and the use of resources when the expense is recognised on approval rather than based on administrative staging of payments over time, which if taken as the recognition point for the expense, artificially distorts the underlying financial performance and position.

16. R3 preferred to recognise the expense in the same period they receive the funding for the grant rather than over time even when the grant is for multiple years.

17. R5 noted the narrow interpretation of obligating events would create unintended consequences. R5 requested broadening the guidance on determining an obligating event so they can continue to meet the needs of the users of their financial statements.

18. R1 requested that the IPSASB considers the interpretation of performance obligations and the resulting impact on fair presentation of the underlying transaction.

19. The CP proposes the PSPOA for expense transactions with performance obligations *or* stipulations. The CP has no discussion on the public sector grantors' type of expense – that is transactions with no performance obligations but there are stipulations over use.

20. The public sector grantors' comments seem to suggest that they would probably support the Board's proposed framework for the recognition of expenses. The Board has noted the PSPOA is not appropriate for expense transactions with no performance obligations but there are stipulations. For these types of transactions, the Board's proposed Obligating Event Approach (OEA) would be appropriate. Under the Board's proposed OEA, the expense and liability of the public sector grantors' grants would be recognised when the obligating event occurs. There is no deferral because once the grant has been accepted by the recipients, the public sector grantors cannot avoid the future outflow of resources: there is no resource presently

controlled by the public sector grantor when the obligating event occurs i.e. the definition of an asset is not satisfied.

21. The draft comment letter has noted that the IPSASB should consider mandating the other comprehensive income (OCI) option for revenue transactions with no performance obligations but there are consumption-based stipulations. For the presentation option, the draft comment letter has recommended the IPSASB makes the requirements under the presentation proposal optional, because mandating this would create extra compliance costs for preparers, particularly for those entities that are not significantly impacted by stipulations over use. For expense transactions with no performance obligations but there are consumption-based stipulations, the draft comment letter is silent on whether the guidance should be mandatory or optional.

22. We recommend that the Board reconsiders the point about making the OCI option mandatory for the following reasons.

    (a) The public sector grantors would not support mandatory requirements for the OCI option for the recognition of expenses (the reasons are outlined above).

    (b) To maintain consistency with the draft response for the presentation option where the Board has recommended that the requirements under this proposal are optional.

    (c) This adds unnecessary complexity for recipients where stipulations are not a major issue.

    (d) There are precedents in IFRS Standards where the use of OCI is optional, for example cash flow hedge accounting is optional under IAS 39 *Financial Instruments: Recognition and Measurement* and in IFRS 17 *Insurance Contracts*, the recognition of insurance finance income or expenses in OCI is an accounting policy choice[2].

Question for the Board
Does the Board agree to change the point in the draft comment letter on the OCI option for the recognition of revenue from mandatory to optional?

23. Other than the question for the Board above, the public sector grantors' points are matters for noting and have not led to any changes to the NZASB's draft comment letter.

Question for the Board
Does the Board agree that no changes are required to the NZASB's draft comment letter from the public sector grantors' responses?

[2] IFRS 17.90 states:
If an entity chooses the accounting policy set out in paragraph 88(b) or in paragraph 89(b), it shall include in other comprehensive income the difference between the insurance finance income or expenses measured on the basis set out in those paragraphs and the total insurance finance income or expenses for the period.

R2's main comments

24. R2 generally agreed with the CP's preliminary views.

25. R2 noted guidance will be required for all the proposed approaches. Preparers will need guidance to assist them with the application of the standard(s).

26. In terms of revenue recognition, R2's clients supported classifying time requirements as a condition. The clients believed time requirements result in a constructive obligation. The clients wanted to match the revenue with the expense. The clients also believed this option would be easy to implement and lead to consistency in the sector even though it is inconsistent with the definition of a liability.

27. R2 supported the other comprehensive revenue and expense option (OCRE) as this a compromise to following "a pure framework definition technical approach such as that contained in" the presentation option. This option will allow entities to match the revenue with the corresponding expense.

28. R2 supported modifying the requirements to require services in-kind that satisfy the definition of an asset to be recognised in the financial statements. They have seen significant divergence in practice. R2 provided examples of divergence in relation to peppercorn leases, loans of artwork for no consideration, secretarial services and accounting services.

29. In terms of non-exchange expenses, R2 noted the EOEA is complex. They see the benefit of the approach but questioned whether preparers will experience the same difficulty as for revenue in distinguishing an expense transaction as exchange or non-exchange. They thought a performance obligation approach may be better. The Board's proposed framework for the recognition of expenses distinguishes between transactions with performance obligations and those without performance obligations.

30. R2's points are matters for noting (and possible future action). They have not led to any changes to the NZASB's draft comment letter.

Question for the Board
Does the Board agree that no changes are required to the NZASB's draft comment letter from R2's response?

R4's main comments

31. R4 generally agreed with the CP's preliminary views.

32. R4 noted they are also a bond issuer on the New Zealand, Swiss and Singapore Stock Exchanges. Part of their reporting requirements for registration on the international stock exchanges is to identify differences between the PBE Standards adopted and IFRS Standards. Thus, it is helpful for the readers or bondholders of R4's annual report to see that there are no major differences between PBE standards and IFRS Standards. This is a valid point and we have included this in the response to Preliminary View 1 (PV) of the draft comment letter.

33. R4 noted that one of the challenges with the implementation of IPSAS 23 is determining whether a stipulation is a condition or a restriction. They noted the requirements of PBE IPSAS 23 *Revenue from Non-Exchange Transactions* have challenged the "old matching principle" practice as it requires the reporting entity to assess if the revenue should be recognised up front or as a liability, and then be recognised over time. R4 does not support deferring the recognition of revenue unless there is a clear enforceable performance obligation. We have included the stipulation distinction challenge in the draft comment letter. The Board's proposed framework removes the distinction between conditions and restrictions because the Board's proposed framework is based on the definition of a liability. Revenue is not deferred unless there is an enforceable and specific agreement to transfer goods or services to other external parties.

34. R4 supported the presentation option but acknowledges that this may not meet all users' needs. They do not rule out the OCRE option as recycling may address some of the challenges with time requirements. They have reservations around recycling as it does not address all the judgement surrounding Category B transactions. In the draft comment letter, the Board has proposed the IPSASB considers both the presentation and OCI options.

35. R4 supported the PSPOA as it is easier to assess if a revenue transaction has a performance obligation rather than if a stipulation is a condition. The PSPOA should only be for distinct performance of providing goods or services. Distinct meaning separately identifiable. The PSPOA should be applied to three party arrangements. These points are consistent with the draft comment letter. Throughout the draft comment letter, the Board has emphasised the PSPOA is appropriate only for transactions with performance obligations. This requires the transfer of resources to an external party in an enforceable and sufficiently specific agreement.

36. R4 recognised that the revenue from capital grants to the extent of the resources spent during the period. This is consistent with the Board's proposed OCI approach where the stipulations are satisfied as the resources are spent in the manner specified by the resource provider: revenue is recycled to surplus or deficit when the resources are spent.

37. R4 noted that the PSPOA could be applied to capital grants as there is an identifiable performance obligation. The Board does not support the PSPOA for capital grants because there is no transfer of goods to an external party. The Board has proposed either a presentation approach or an OCI approach.

38. In terms of non-exchange expenses, R4 noted that an expectation or a non-legally binding arrangement does not create a liability. They also noted that non-legally binding obligations under the EOEA creates a difficult judgement exercise for public sector entities. They accepted that universally accessible services and collective services should be expensed as incurred. R4 supported the PSPOA for expenses with performance obligations.

39. For the subsequent measurement of non-contractual receivables, R4 preferred the cost approach as it is easier to apply. This approach avoids the potentially arbitrary decision on market interest rates. Preparers can still "use the discounting of cash flows and assessment of proper interest rates in determining the recoverable amount".

40. Most of R4's points are matters for noting. Other than the points on bond listing on international stock exchanges and the challenges with distinguishing stipulations as either conditions or restrictions, the other points have not led to any changes to the NZASB's draft comment letter.

Question for the Board
Does the Board agree that no further changes are required to the NZASB's draft comment letter from R4's response?

R6's main comments

41. R6 did not provide a response to all the PVs and Specific Matters for Comment (SMCs). Their response was mainly on the recognition of revenue and provided a general comment on the recognition of expenses. They supported the PVs where they provided a response.

42. R6 noted inconsistent application of the scope of transactions as either in IPSAS 23 or IPSAS 9 *Revenue from Exchange Transactions*/IPSAS 11 *Construction Contracts*. The scope is driven by the desire to smooth revenue. There is uncertainty whether the transfer of goods or services to beneficiaries is a non-exchange transaction. In the draft comment letter, the Board has noted that transactions with performance obligations and the transfer of goods or services to beneficiaries should be accounted for using the PSPOA.

43. R6 noted that in the ideal scenario Category B transactions do not exist. Transactions not in the scope of an IPSAS based on IFRS 15 *Revenue from Contracts with Customers* would be in the scope of an updated IPSAS 23.

44. R6 preferred the presentation option. This option allows the recipient "to provide quantitative disclosures to explain the peaks and troughs in revenue where this may seemingly be different from the perceived point of the agreement with the" provider. This option should not be onerous on the preparer and reader of the financial statements." In the draft comment letter, the Board has noted that this option should not be mandatory and the IPSASB should consider developing illustrative examples.

45. R6 noted concerns with the OCI option as recycling may appear to double count the resources (the first time when recognised directly in equity if shown as OCI and the second time when recycled to surplus or deficit). R6 proposed an alternative option, which is to move future funds out of retained earnings into a separate reserve. Revenue is recognised on day 1 and then transferred to a reserve within equity. R6 noted this option is possible under the current framework. Staff note that the OCI option with recycling does not result in the double counting of revenue because the effect on the surplus or deficit is nil when the revenue is recycled in the period the resource is used. R6's alternative approach is very similar to the OCI option.

46. For expense recognition R6 noted that there is merit in a matching principle, depending on the outcome of conclusions on revenue recognition. The basic concept that expenses are recognised as incurred is simple, easy to apply and consistent with the underlying framework.

47. R6's points are matters for noting. They have not led to any changes to the NZASB's draft comment letter.

Question for the Board
Does the Board agree that no changes are required to the NZASB's draft comment letter from R6's response?

R7's main comments

48. R7 generally agreed with the PVs in the CP. They plan to provide a separate submission to the IPSASB.

49. R7's main concern is the PSPOA has not been broadened enough to capture specific and enforceable obligations but there is no transfer of goods or services (including capital grants). R7 thought these transactions are sufficiently similar to an obligation imposed by the funder to transfer a good or service.

50. The Board has considered broadening the PSPOA for revenue transactions with no performance obligations but with consumption-based stipulations and enforcement mechanisms. The resource recipient satisfying those "obligations" does not result in an outflow of resources as the funds received will be spent on acquiring resources for the entity itself, rather than transferring goods or services to other external parties, so a liability does not exist. The deferral of revenue and "other obligations" was dismissed by the Board because it does not satisfy the definitions of elements in the Conceptual Framework.

51. R7 suggested that if the PSPOA is not broadened for the types of transactions above, the update to IPSAS 23 should be broadened to include these types of transactions as well as those with just time requirements.

52. R7 noted that some of the issues identified in the CP for grant recipients are also relevant for grant providers.

53. The Board considered broadening the PSPOA for grant providers as well and came to the same conclusion as for revenue. The resource recipient satisfying those specific and enforceable "obligations" will spend the resources received on acquiring other resources for the recipient itself, rather than transferring goods or services to the resource provider or specified beneficiaries. The deferral of expense and "other resources" was dismissed by the Board because it does not satisfy the definitions of elements in the Conceptual Framework.

54. In terms of issues encountered with applying IPSAS 23, R7 noted an issue with determining when a receivable asset arises under a grant arrangement. Determining the asset recognition and measurement can be challenging when grants are paid over time and future payments are conditional on the grantee performing an action or reaching a milestone. The grantee's performance may or may not be wholly within its control. The draft comment letter has identified matters for the IPSASB to consider in developing a residual revenue standard (or section of a revenue standard) based on updating the applicable content from IPSAS 23. The draft comment letter is directed more at transactions with no performance obligations or no

stipulations. R7's comments are for grant arrangements with stipulations. Under the Board's proposed framework, revenue from such arrangements would be recognised when received or receivable with either the presentation option or OCI option to highlight the stipulation.

55. R7 preferred the OCI option with recycling to surplus or deficit as the solution for revenue transactions with time requirements.

56. R7 supported retaining the existing requirements for services in-kind. Most public sector entities do not recognise services in-kind. They are not aware of any concerns in the public sector on this matter.

57. R7 thought there was little merit in considering the application of the EOEA for universally accessible services and collective services because there are no performance obligations on the recipients. The important issue for the IPSASB to address is the liability recognition point as this drives the expense recognition.

58. R7 thought that the IPSASB needed to provide further reasons and analysis on why expenses are recognised as services are incurred for universally accessible services and collective services. R7 suggested that the IPSASB considers its work in the social benefits project to strengthen its support for PV 6.

59. For the subsequent measurement of non-contractual payables, R7 preferred the IPSAS 19 requirements. Their preference is to follow an approach that closely aligns with subsequent measurement for non-contractual receivables. Different subsequent measurement for non-contractual receivables and non-contractual payables would be confusing for preparers and users of the financial statements. This is likely to be a concern for entities that report on both non-contractual receivables and non-contractual payables for the same tax.

60. R7's points are matters for noting. They have not led to any changes to the NZASB's draft comment letter.

Question for the Board

Does the Board agree that no changes are required to the NZASB's draft comment letter from R7's response?

Next steps

61. We propose that the Chair and Board members who would be interested complete the final review of the comment letter during the week beginning 18 December. The comment letter will be submitted during the week beginning 8 January 2018.

Attachments

Agenda item 3.2: NZASB draft comment letter on IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

Agenda item 3.3: Submissions received

3.3.1 R1 Broadcasting Commission (NZ On Air)

3.3.2 R2 BDO New Zealand Limited

3.3.3 R3 New Zealand Film Commission

3.3.4 R4 Auckland Council

3.3.5 R5 Te Māngai Pāho

2.3.5 R6 Confidential

3.3.6 R7 Audit NZ

Agenda item 3.4: IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (in supporting papers)

APPENDIX 1: Summary of the Board's views

1. This appendix provides a summary of the Board's views on the CP discussions to date.

2. At the NZASB meeting in September the Board agreed:

   (a) the areas of focus for the Board's comment letter are the proposed approaches for the recognition of revenue and non-exchange expense; and

   (b) the other topics covered in the CP may be important to our constituents but due to the short comment period the Board's comment letter will have high-level comments.

3. At the NZASB meeting in October the Board provided feedback on the revenue recognition approaches proposed in the CP. The Board agreed:

   (a) the proposed framework for recognition of revenue transactions in the public sector and not-for-profit sector should be classified as those with performance obligations or those without performance obligations rather than exchange or non-exchange distinction;

   (b) revenue transactions in Category C[3] should be accounted for using the Public Sector Performance Obligation Approach (PSPOA), which is based on IFRS 15 *Revenue from Contracts with Customers* adapted for the public sector;

   (c) revenue transactions in Category A[4] should be accounted for under a residual standard (or a residual section of the standard, if there is only one standard on revenue), which could be an updated IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers);*

   (d) there is a wide spectrum of revenue transactions in Category B[5]. The scope of Category B transactions that could be accounted for using the PSPOA will depend on how the IPSASB defines key factors such as enforceability and performance obligation;

   (e) revenue transactions in Category B where there are enforceable performance obligations to transfer goods or services to other parties (including transactions involving transfers to beneficiaries and for subsidised goods or services) should be accounted for using the PSPOA; and

   (f) revenue transactions in Category B where there are stipulations over use (but do not necessarily involve the transfer of goods or services to the resource provider or beneficiary) or only time requirements could be accounted for under an updated IPSAS 23 approach using either the presentation option or the other comprehensive revenue and expense with recycling option.

---

[3] Revenue transactions within the scope of IFRS 15.

[4] Revenue transactions with no performance obligations or stipulations over use.

[5] Revenue transactions with performance obligations or stipulations but do not have all the characteristics of a transaction within the scope of IFRS 15.

4. The Board agreed an overview of the Board's proposed framework for revenue recognition in the public sector (as noted above) should precede the responses to the preliminary views and specific matters for comment. The overview will set the scene for the IPSASB on the Board's thinking and rationale for the responses to the preliminary views and specific matters for comment. The responses to each preliminary view and specific matter for comment should be linked back to the overview where appropriate.

5. At the NZASB meeting in November the Board provided feedback on the non-exchange expense recognition approaches proposed in the CP. The Board noted:

   (a) that the CP has not provided a conceptual basis for the recognition of an asset if there is a return condition under the Extended Obligating Event Approach;

   (b) that for the recognition of non-exchange expense the first question to ask is when does an obligating event arise. The guidance on an obligating event can be drawn from IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* and the IPSASB's *Conceptual Framework*. The recognition of an asset will be subject to a number of factors;

   (c) that non-exchange expense transactions with enforceable performance obligations to transfer goods/services to the resource provider or beneficiaries could be accounted for using a simplified public sector performance obligations approach;

   (d) that there is not much conceptual difference between the transactions in Exposure Draft 63 *Social Benefits* and universally accessible services and collective services so the accounting for these expenses should be consistent; and

   (e) that non-exchange expense transactions with no performance obligations but with stipulations over use could be recognised when the obligating event arises with a presentation option or other comprehensive revenue and expense with recycling option to address stipulations.

6. At the additional NZASB meeting in November the Board provided feedback on the draft comment letter. The Board:

   (a) considered the Working Group's feedback on moving the line on revenue and expenses for arrangements with no performance obligations but with specific consumption-based stipulations and enforcement mechanisms to apply the PSPOA, but agreed to retain the NZASB's proposed framework, to be consistent with the definitions of elements in the IPSASB's Conceptual Framework; and

   (b) agreed that for capital grants and revenue transactions with no performance obligations but with stipulations over use (including permanently restricted assets), that under the OCRE option, the recycling to surplus or deficit should occur when the resource recipient has spent the funds as specified by the resource provider.

(c) agreed that the draft comment letter would include:

(i) the NZASB's consideration of applying the PSPOA for revenue transactions with no performance obligations but with specific consumption-based stipulations and enforcement mechanisms, because these transactions could be deferred under the "other obligations" approach of the IPSASB's Conceptual Framework and why it was eventually dismissed;

(ii) the NZASB's consideration of applying the PSPOA for expense transactions with no performance obligations but with specific consumption-based stipulations and enforcement mechanisms, because these transactions could be deferred under the "other resources" approach of the IPSASB's Conceptual Framework and why it was eventually dismissed;

(iii) the presentation option and OCRE option for expense transactions with no performance obligations but with consumption-based stipulations and to acknowledge that the Board had mixed views over these options. The majority of the Board members prefer the presentation option with a minority preferring the OCRE option; and

(iv) a point in the cover letter on how the short comment period on the CP for such broad and important topics has limited the NZASB's detailed response only to the most significant issues and for this reason high-level response for the other issues.

APPENDIX 2: Respondents' comments and staff response

Cover letter

Only R7's cover letter is analysed below because the other respondents did not summarise their comments in their cover letter.

R#	Comments	Staff response
R7	We appreciate the opportunity to comment to the NZASB on the IPSASB's Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (the CP). We also appreciated the opportunity to participate at the NZASB Working Group meetings on the CP. The accounting for revenue and non-exchange expenses is a challenging and important area in public sector accounting. We are pleased the IPSASB is progressing the development of improved revenue standards and a standard on public sector expenses.	This is consistent with the draft comment letter.
	We are concerned that moving away from the "condition" accounting approach of IPSAS 23 to a "performance obligation" approach as proposed under the PSPOA could result in revenue being recognised earlier, despite an expectation from the funder that the entity perform an enforceable task or deliverable. We consider the performance obligation notion of the PSPOA needs to be broadened further than proposed by the IPSASB to capture those transactions that do not transfer a good or service but there is an enforceable obligation on the grant recipient to perform a specific task or deliverable. If the PSPOA is not broadened further, we expect it would give rise to issues similar to time-requirement issues experienced under IPSAS 23. If the IPSASB decides not to broaden the PSPOA, then it should consider broadening the time-requirement options to also cover arrangements with deliverables imposed by the funder that are enforceable but don't involve the transfer of a good or service.	The Board has considered broadening the PSPOA for revenue transactions with no performance obligations but with consumption-based stipulations and enforcement mechanisms. The resource recipient satisfying those "obligations" does not result in an outflow of resources as the funds received will be spent on acquiring resources for the entity itself, rather than transferring goods or services to other external parties, so a liability does not exist. The deferral of revenue and "other obligations" was dismissed by the Board because it does not satisfy the definitions of elements in the Conceptual Framework.
	A number of the issues identified by the CP for grant recipients are also relevant to grant providers. We recommend the IPSASB also consider the accounting for capital grants and time-requirements from the grant provider's perspective. Our responses to the IPSASB's Preliminary Views and Specific Matters for Comment are attached. We plan to provide a separate submission to the IPSASB on the CP.	The Board considered this for the grant providers as well and came to the same conclusion as for revenue. The resource recipient satisfying those specific and enforceable "obligations" will spend the resources received on acquiring other resources for the recipient itself, rather than transferring goods or services to the resource provider or specified beneficiaries. The deferral of expense and "other

R#	Comments	Staff response
		resources" was dismissed by the Board because it does not satisfy the definitions of elements in the Conceptual Framework. We propose no amendments to the draft comment letter from R7's responses.

Preliminary View 1 (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 reason.

R#	Comments	Staff response
R2	Yes, we agree with Preliminary View 1. Moving to revenue recognition based on IFRS 15 will assist with reducing divergence in accounting treatment between PBEs and for-profits here in New Zealand.	This is consistent with the draft comment letter.
R4	We support the view of the IPSASB that Category C transactions or transactions which involve enforceable agreements, with performance obligations to transfer goods or services to customers on commercial terms should be accounted for under an IPSAS based on IFRS 15 requirements. We support public sector accounting standards convergence with the private sector's IFRS Standards as Auckland Council Group is a mixed group which means that the entities under the Group are adopting both PBE Standards and IFRS Standards. During consolidation, the Group identifies and adjusts differences resulting from being in a mixed group. Thus, for the Auckland Council Group, better convergence of PBE Standards with IFRS means fewer differences or adjustments during consolidation and reporting. Auckland Council is also a bond issuer in the New Zealand Stock Exchange (NZX), Swiss and Singapore Stock Exchanges. Part of the Group's requirements in the international stock exchanges is to identify differences between the PBE Standards adopted by	This is consistent with the draft comment letter. This is a valid point. We have included this in the draft comment letter.

R#	Comments	Staff response
	Auckland Council Group and IFRS Standards. Thus, it is helpful for the readers or bondholders of Auckland Council Group's annual report to see no major differences between PBE Standards and IFRS Standards.	
R6	Yes – IFRS 15 provides more prescriptive guidance to apply the revenue recognition than its predecessors IAS 18 and IAS 11. Adopting a similar approach will provide more consistency across IPSAS reporters.	This is consistent with the draft comment letter.
R7	We generally agree. However, our preference is that transactions within the scope of the PSPOA are addressed in an IFRS 15-equivalent standard that is amended for the PSPOA, rather than as a separate standard or part of an amended IPSAS 23.	This is consistent with the draft comment letter. The Board agreed not to discuss the geography of the IPSAS based on IFRS 15 in the draft comment letter. We propose no amendments to the draft comment letter from R7's response.

Preliminary View 2 (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.

<table>
<tr><th>R#</th><th>Comments</th><th>Staff response</th></tr>
<tr><td>R2</td><td>Yes, we agree with Preliminary View 2.</td><td rowspan="4">The comments are broadly consistent with the draft comment letter. Category A transactions would be accounted for under a residual revenue standard or a residual section of a revenue standard, based on the applicable parts of IPSAS 23.
We propose no amendments to the draft comment letter from R2, R4, R6 and R7's responses.</td></tr>
<tr><td>R4</td><td>We support the preliminary view of the IPSAS to account for those transactions with no performance obligations or non-exchange transactions under an updated IPSAS 23.</td></tr>
<tr><td>R6</td><td>Yes – when it is clear that there are no on-going performance obligations, these transactions are clearly outside the scope of IPSAS 9 and IPSAS 11, therefore should be guided by IPSAS 23.</td></tr>
<tr><td>R7</td><td>Yes, we agree.</td></tr>
</table>

Specific Matter for Comment 1 (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.

R#	Comments	Staff response
R2	We have no comments on taxes with long collection periods. In terms of social contributions, in the not-for-profit (NFP) sector we have seen significant divergence in practice when entities are receiving funds from the Crown to provide services to members of the public. There is great confusion as to whether or not these social contributions are exchange or non-exchange in nature and thus whether they are in the scope of PBE IPSAS 9 or PBE IPSAS 23. In discussing this issue with clients, it is clear that they require significant additional guidance on the differences between exchange and non-exchange revenue, and would greatly benefit from having relevant illustrative examples included in this guidance. We have not identified any other significant areas not covered (elsewhere) by the Consultation Paper.	The interpretation of social contributions is different to what the IPSAS literature had intended. Social contributions are revenue for social benefit schemes[6] rather than revenue received to provide social services to the public. The Board is proposing the recognition of revenue which distinguishes revenue transactions between those with performance obligations or those without performance obligations rather than continuing with the exchange or non-exchange distinction. We propose no amendments to the draft comment letter from R2's response.
R4	The Group has no major difficulty in applying the requirements of PBE IPSAS 23 since it adopted the PBE Standards to its revenue streams. The one challenge for the Group is the general issue for non-exchange transactions in identifying if a stipulation is a "condition" or a "restriction". The requirements of PBE IPSAS 23 have challenged the "old matching principle" practice as it requires the business to assess if the revenue should be recognised up front or as a liability and be recognised over time. Accordingly, we encourage the IPSASB to explicitly address the "old matching principle" through disclosure by providing guidance. We are not supportive of allowing entities to defer recognition of revenue unless	This is broadly consistent with the draft comment letter. The challenge with distinguishing stipulations as either conditions or restrictions is a valid point and we have included this in the draft comment letter. Same comment as above on the Board's proposed framework for revenue. The Board has also proposed removing the distinction between conditions and restrictions because the framework is based on the definition of a liability. Revenue is not deferred unless there is an enforceable and specific agreement

[6] Exposure Draft 63 *Social Benefits*, BC93

R#	Comments	Staff response
	there is a clear “performance obligation” that is enforceable.	to transfer goods or services to other external parties.
R6	Inconsistent application of transactions being in the scope of IPSAS 23 and IPSAS 9 or IPSAS 11. These inconsistencies arise between different entities interpreting whether a transaction is an exchange transaction, or non-exchange. It feels this is typically driven by their desire to ‘smooth’ revenue to avoid a large surplus in year 1 and deficit’s in year 2. Inconsistencies are also possible at the same entity when interpreting similar arrangements, but a different accounting approach is taken.	This is broadly consistent with the draft comment letter. Same comments as in R4 above.
	More detailed guidance on when a transaction is an exchange transaction or non-exchange transaction would assist preparers to apply consistently. In Australia, the recent release of AASB 1058 and the application guidance (Appendix F) for IFRS 15 for not-for-profit entities provides guidance on when transactions are in the scope of IFRS 15. This also includes guidance when one party provides funding, but another party receives the benefit (e.g. government provides funds to provide health services to the community). Such three-way arrangements are typical in the NFP sector, but interpretation varies as to whether the fact that a different party receives the benefit means that it is non-exchange.	This is broadly consistent with the draft comment letter. Same comments as in R4 above. The draft comment letter agreed that three party arrangements should be accounted for under the PSPOA if the goods or services are transferred to the beneficiaries. We propose no amendments to the draft comment letter from R6’s response.
R7	An issue encountered with IPSAS 23 is determining when a receivable asset arises under a grant arrangement. IPSAS 23 provides limited guidance on asset recognition and measurement for grant arrangements. Determining the asset recognition and measurement accounting for grant arrangements can be challenging when grant funds are paid over time and future payments are conditional on the grantee performing an action or reaching a specified milestone. In such examples, the grantee’s performance may or may not be wholly within their control. It would be helpful if further guidance was provided on when the funding under a grant arrangement meets the asset recognition criteria and the measurement of that asset. Further application issues in the context of related SMC and PVs questions are addressed in the relevant sections of this comment letter.	The draft comment letter has identified matters for the IPSASB to consider in developing a residual revenue standard (or section of a revenue standard) based on updating the applicable content from IPSAS 23. The draft comment letter is more directed at transactions with no performance obligations or stipulations. R7’s comments are for grant arrangements with stipulations. Under the Board’s proposed framework, for such arrangements, revenue would be recognised when received or receivable with either the presentation option or OCI option to highlight the stipulation.

R#	Comments	Staff response
		We propose no amendments to the draft comment letter from R7's response.

Preliminary View 3 (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.

R#	Comments	Staff response
R2	Yes, we agree as this approach will lead to consistency of revenue recognition with Category A and Category C transactions. In addition, moving revenue recognition for Category B transactions to this approach will reduce divergence between the for-profit and PBE sectors in terms of revenue recognition methodology.	This is broadly consistent with the draft comment letter. However, the Board does not agree all Category B transactions should be accounted for using the PSPOA. Only transactions with performance obligations should be accounted for under the PSPOA.
	However, we do note that this approach will require a significant amount of education and application guidance (including relevant examples) as this approach requires a completely new approach to accounting for revenue than is currently applied.	The Board has noted that the IPSASB would need to develop an appropriate definition of a performance obligation with supporting guidance. The Board has noted a number of things for the IPSASB to consider when they develop an IPSAS based on IFRS 15, see draft response to PV 1.
	We also note that this approach may be considered onerous for smaller Tier 2 NFP entities that do not have significant accounting resources or the funds to outsource the accounting requirements of their organisations.	We can consider R2's comments when the IPSASB develops its ED. We propose no amendments to the draft comment letter from R2's comments.
R4	Yes, we are supportive of this view. Please see our detailed response on revenue recognition in the next page.	This is broadly consistent with the draft comment letter.
R6	The ideal scenario is that category B transactions do not exist. With an updated revenue IPSAS (i.e. replace IPSAS 9 and IPSAS 11 with something similar to IFRS 15), and additional guidance in IPSAS 23 on what is exchange or non-exchange, transactions should either be in the scope of the new IPSAS revenue or in IPSAS 23. This would reduce inconsistent application of the principles of an exchange transaction.	This is broadly consistent with the draft comment letter. The Board has noted that establishing clear boundaries for different recognition approaches will be important when for drafting EDs and standards. The boundary for different recognition approaches will depend on how far the IFRS 15 concept of performance

R#	Comments	Staff response
		obligations is stretched to reflect the public sector context. The Board has proposed that Category A transactions and Category B transactions with no performance obligations but with consumption-based stipulations be located in a residual revenue standard or residual section of a revenue standard. We propose no amendments to the draft comment letter from R6's comments.
R7	We generally agree with the IPSASB developing a PSPOA approach. However, we consider a broader notion of "performance obligation" needs to be developed. This is discussed further in our comments in SMC 2 below. For those transactions with "time-based" stipulations that would not qualify for the PSPOA, the IPSASB needs to consider the accounting options included in SMC 3 below. Under the CP, the IPSASB proposes only to consider time-based stipulations under Approach 1 of enhancing IPSAS 23. The IPSASB should also consider time-based stipulations under Approach 2 of the PSPOA as the issue is relevant under both approaches.	This is broadly consistent with the draft comment letter. See staff response under SMC 2 below. A time requirement in and of itself does not create a performance obligation. We propose no amendments to the draft comment letter from R7's comments.

Specific Matter for Comment 2 (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.

R#	Comments	Staff response
R2	Yes, we agree with the proposals.	This is consistent with the draft comment letter.
R4	We agree with the proposals on how each of the IFRS 15 five-steps could be broadened especially the "identification of binding arrangement" which considers	This is consistent with the draft comment letter.

R#	Comments	Staff response
	the public sector transactions and the concept of "performance obligation" which includes a three-party revenue transaction. Please see more details in our response on revenue recognition in the next page.	
R7	We have a significant concern with step 2 – identify the performance obligation. Paragraph 4.46 of the CP explains that a performance obligation only includes activities that an entity must undertake to fulfil a contract and where those activities transfer a good or service to a customer. The IPSASB considers this principle would need to be preserved in developing a broadened PSPOA. We are concerned that the IPSASB intends to develop a broadened PSPOA with a performance obligation notion that is too narrow and would apply only where a funding contract results in a good or service being transferred to a funder or beneficiary. This may result in some transactions that include conditions (and therefore revenue deferrals may be recognised under IPSAS 23) no longer being eligible for revenue deferral under a broadened PSPOA. We consider a contract that includes specific deliverables and is enforceable by the funder that does not involve the transfer of a distinct good or service to the funder/beneficiary should be eligible for accounting under the PSPOA. This is because in substance it is sufficiently similar to an enforceable obligation imposed by a funder to transfer a good or service. For example, a District Health Board (DHB) enters into a 2-year multi-year grant agreement totalling $800K to fund the salary costs for a project manager and support staff to review the DHBs systems and processes to improve cancer treatment times and then implement system improvements. The DHB is required to report quarterly to the funder on progress on the project deliverables and salary costs incurred. Funds are provided quarterly in advance subsequent to the receipt of the prior quarter's quarterly report and unspent funds are refundable to the funder at the end of the arrangement. The funder has the ability to cancel the contract or cease future payments in the event of non-performance under the contract. This example raises the issue of when an asset arises under the contract and the amount of that asset, and when revenue is recognised following recognition of the asset.	The Board has noted that the PSPOA is only appropriate for revenue transactions with performance obligations – that is, transactions with enforceable and specific obligations to transfer goods or services to the resource provider or agreed beneficiaries. See staff response to the cover letter above.

R#	Comments	Staff response
	In this example, the DHB is required to perform a specific task, which is monitored by the funder and is enforceable. Satisfying the performance expected in the funding arrangement also requires an economic outflow in the form of future salary costs. This example also illustrates that while there may not be an immediate directly observable output to a beneficiary, the expenditure is contributing to an outcome of improving treatment times. This would be of general benefit to users of the public health system. We therefore consider this type of arrangement should be accounted for following the PSPOA framework because in substance it is sufficiently similar to an obligation imposed by the funder to transfer a good or service. We urge the IPSASB to develop a broadened PSPOA that is broad enough to capture those contracts with clear deliverables imposed by the funder that are enforceable but do not involve the transfer of a distinct good or service to a funder or beneficiary.	
	If the PSPOA is not broadened further, we expect issues will emerge similar to time-requirement issues experienced under IPSAS 23. If the IPSASB does not broaden the PSPOA as recommended, the time-requirement options in SMC 3 below should be broadened to apply to contracts with deliverables imposed by the funder that are enforceable but don't involve the transfer of a distinct good or service to a funder or beneficiary.	Under the Board's proposed framework, the Board has proposed the presentation option and OCI option for revenue transactions with no performance obligations but with consumption-based stipulations. We propose no amendments to the draft comment letter from R7's response.

Specific Matter for Comment 3 (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.

R#	Comments	Staff response
R2	We have discussed this issue in detail with a number of our NFP clients. The vast majority of these clients would favour option (c). These entities believe that a time requirement stipulation results in a constructive obligation to ensure funds are expended in the specified period. Their operational activity is to ensure that revenues received are matched to the related expenses based on the stipulations of the grantor, and that is how they manage their operations and (if applicable) report to the relevant grantor. These entities believe that option (c) would be easy to implement, cost effective, and would lead to consistency in the sector, even though this option is inconsistent with the IPSASB Conceptual Framework/ PBE Conceptual Framework and IPSAS/PBE Standards.	The Board does not support option (c) because it does not satisfy the definition of a liability. Under the Board's proposed framework, the presentation option and OCI option have been suggested as possible solutions for communicating the recipient's performance story.
	We would favour option (e) as it is a compromise to following a pure framework definition technical approach such as contained in Option (b). It will allow entities to "defer" the revenue received from the Category B transactions in other comprehensive income and expense and recycle the revenue to surplus and deficit once the corresponding expenses are incurred, thus allowing entities to "match" the revenue with the corresponding expenses, which appears to be what is desired by these entities. This option will likely require significant education to be provided as it is a more complex approach and the vast majority of entities in the NFP sector will not have been exposed to option (e) accounting before. However, some of the larger NFP entities that hold financial instruments in the available for sale category will be familiar with this accounting treatment concept and should be able to apply the concepts without significant effort.	This is consistent with the draft comment letter. The Board has proposed the OCI option as one solution to explain the resource recipient's performance story and at the same time provide a faithful representation of its financial position. We can consider R2's comments when the IPSASB develops its ED. We propose no amendments to the draft comment letter from R2's response.
R4	Although we consider that these approaches can be used for revenue recognition, we are not entirely supportive of these options. Please see our detailed response on revenue recognition in the next page.	See staff response under SMC 4 above.
R6	Preference is Option (b). On the basis additional guidance is provided for determining transactions in scope, option b allows the entity to provide qualitative disclosure to explain peaks and troughs in revenue where this may seemingly be different from the perceived point of the agreement with the funding	This is consistent with the draft comment letter. The Board has provided a NZ example where the entity used presentation to tell its performance story.

R#	Comments	Staff response
	party. Whilst this is optional now, entities are generally reluctant to provide additional disclosure that isn't required disclosure. Some consideration would need to be given to ensure that required disclosures are not onerous from a preparation perspective, but also for the reader. Given recent movements internally regarding streamlined financial statements, disclosure on non-exchange revenue can be meaningful to the reader, provided it does not become onerous. Concerns with other options include: Option (c) classify time requirements as a condition – concerned that this would undermine the basic accounting framework of what is a liability.	The Board has recommended that the IPSASB makes the presentation proposals optional but encourages these proposals in the period the resources are received, and provides illustrative examples of what the presentations could look like. This is consistent with the draft comment letter.
	Option (d) classify transfers with time requirements as other obligations – similar to option (c), concerned that this begins to create 'fictitious liabilities' on the balance sheet. However, this would be preferable to option (c) given that it would clearly be shown as a separate type of liability.	This is consistent with the draft comment letter. The Board does not support this option because time requirements are not an economic phenomena that should be treated any differently from other stipulations.
	Option (e) recognise transfers with time requirements in equity and recycle – agree with comments in 4.24 that this could introduce the concept of other comprehensive income. Concerned that if recognised as OCI, recycling may appear to 'double count' the funding (the first time being when recognised directly in equity if shown as OCI, the second when recycled to PL). Alternatively, a 'reserve' could be created in equity to move 'future' funds out of retained earnings into another reserve, which is a similar approach, but the revenue is recognised on day 1 and then transferred within equity. In some respects, this is already possible under the current framework.	The OCI option with recycling does not result in the double counting of revenue because the effect on the surplus or deficit is nil when revenue is recycled in the period the resource is used. The alternative proposed by R6 is similar to the OCI option. We propose no amendments to the draft comment letter from R6's response.
R7	The options to address concerns around time-requirements should also be considered by the IPSASB in implementing Approach 2, the PSPOA. The accounting for funding that includes time-requirements is an important issue for affected entities due to the significant distortions that can arise in the reported financial performance. Distortions can arise when an entity is required to recognise the following year's operating funding grant when it is unconditionally agreed prior to that period, or where an entity receives a multi-year grant and is required to record revenue	We note R7's concerns. The Board has recommended that the IPSASB considers the presentation option and OCI option for arrangements with time based requirements.

R#	Comments	Staff response
	upfront for the full amount of the grant in advance of the costs incurred. An example of such an issue in New Zealand is the Waikato River Clean-Up Trust where the Trust will receive $7 million each year for 22 years. The Trust intends to disburse the funding annually on river clean-up related grants. Because the funding arrangement is unconditional, the funding to be received over the 22-year period is recognised as a receivable and revenue upfront when the agreement was executed. The funds received will then be expensed over the 22-year period as grant arrangements are entered into by the Trust. In this example, the Trust also reports a significant amount of interest revenue to unwind the discounted value of the receivable over the 22-year period, which further distorts the Trust's financial performance. If the IPSASB decides on a recognition solution for time-requirements, we prefer option (e) of transferring the credit entry to net assets and recycling to the surplus or deficit in the period the funding relates to. Sufficient guidance would need to be provided under this option on the timing of the recycling of the credit entry to the statement of financial performance to mitigate manipulation of performance. We note there is precedent for this accounting approach in IPSAS 29 under cash flow hedge accounting where derivative gains and losses are deferred in equity and recycled to the surplus or deficit to match the revenue or expense arising from the risk managed.	This is consistent with the draft comment letter. We propose no amendments to the draft comment from R7's response.

Specific Matter for Comment 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.

R#	Comments	Staff response
R2	(a) Yes, we agree. There is significant confusion as to the understanding of exchange versus non-exchange transactions and this has led to divergence in practice. Additional guidance is definitely required to explain the	The Board does not support the IPSASB retaining the exchange or non-exchange distinction. However, if the IPSASB retains this distinction

R#	Comments	Staff response
	difference between exchange and non-exchange transactions if the IPSASB follows Approach 1. In particular we would encourage the inclusion of specific illustrative examples for common scenarios in the NFP sector, as this will be of invaluable help, especially for the smaller Tier 2 NFP entities.	the Board agreed that additional guidance should be provided and used with its proposed presentation and OCI options. We propose no amendments to the draft comment from R2's response.
R4	Yes, additional guidance on how to assess exchange/non-exchange should be added as it is a significant revenue recognition distinction. Since PBE Standards were adopted by public benefit entities in New Zealand, there have been challenges in assessing what is exchange or non-exchange and if a stipulation is a condition or a restriction. The possibility of convergence with IFRS 15 will add another consideration into the mix which is whether there are performance obligations or not. As an organisation, we will need to continue providing ongoing training to strengthen our finance professional's understanding of the current requirements plus the new requirements. Thus, we strongly encourage the IPSASB and the NZASB (for local requirements) to provide good guidance on the convergence of the old and new standards as part of issuing the new standard. We note that the revenue standard requirements for the public sector are not comparable with the requirements for the for-profit entities due to the non-exchange consideration. The for-profit entities are trying to simplify the revenue standards by consolidating several requirements for recognition into IFRS 15's recognition requirement. The challenge for the IPSASB is to converge with IFRS 15 and at the same time adopt a simplified approach of "how to recognise revenue streams in the public sector".	Same comments as R2 above. The Board is proposing the recognition of revenue which distinguishes revenue transactions between those with performance obligations and those without performance obligations rather than continuing with the exchange or non-exchange distinction. The Board's proposed framework would provide closer convergence with IFRS Standards. The draft comment letter has noted a number of things the IPSASB would need to consider when it develops an IPSAS based on IFRS 15 so it can be applied by the public sector. We will review the transition requirements when the IPSASB develops its ED.
	We would like to dissect some specific matters for comments by the IPSASB in relation to Category B transactions. Category B transactions include those transactions with enforceable agreements, with performance obligations or stipulations to use or consume resources in a particular way; and/or agreement requiring resources to be used over a specified period of time. <u>Option (c) and (d) – Time requirements as a condition or classify as other obligations</u> We are not supportive that time requirement should be consider as a condition or classified as other obligations. The time requirement alone is a common restriction in	This is consistent with the draft comment letter. The Board does not support option (c) and option (d).

R#	Comments	Staff response
	providing or receiving a grant and the common driver of the "old matching principle". We acknowledge that the "old matching principle" is no longer relevant under the new Conceptual Framework and thus, making time requirement as a consideration for not recognising the revenue up front means going back to the "old matching principle".	
	We believe that some public or non-for-profit entities receiving grants for multiple periods/years are having problems in preparing their annual report due to difficulty in presenting an imbalance financial performance wherein in the first period an entity reports a large surplus and in the subsequent periods losses are reported. To address this, these entities are already able to provide additional disclosures to explain to readers the multi-year grants under the current PBE Standards. Thus, we support allowing enhanced disclosure in the annual report, however, we acknowledge that merely the requiring additional disclosures option to account for Category B transactions may not meet all users' needs.	This is consistent with the draft comment letter. The Board has provided a NZ example where the entity used presentation to tell its performance story.
	<u>Option (e) – Recycling in net assets/equity (other comprehensive revenue and expense) and through statement of financial performance</u> In New Zealand, public benefit entities are able to use "Other Comprehensive Revenue and Expense". Auckland Council Group has items presented under Other Comprehensive Revenue and Expense such as revaluation gain on property, plant and equipment. We understand that the IPSASB has not introduced Other Comprehensive Revenue and Expense in the Conceptual Framework. We believe that the recycling method through Net Assets or Other Comprehensive Revenue and Expense maybe a neater and more organised approach rather than just merely providing additional disclosures in the annual report. However, we don't consider that the recycling addresses all the judgement considerations surrounding Category B transactions and adding such a consideration in the mix of required revenue recognition requirements does add complexities to the options for revenue recognition. The recycling may address some challenges in terms of timing restrictions.	This is consistent with the draft comment letter. The Board has recommended that the IPSASB explore the OCI option. This includes developing principles for what should be recognised in OCI. The Board is proposing that OCI is recycled to surplus or deficit when the resources are consumed as specified by the resource provider.
	<u>Public Sector Performance Obligation approach (PSPOA)</u> Auckland Council supports the "Public Sector Performance Obligation" approach. The introduction of	This is consistent with the draft comment letter. The Board has noted that the IPSASB would need to

R#	Comments	Staff response
	IFRS 15 in the for-profit entities aims to simplify the revenue recognition by focusing on "performance obligation". We believe that the term "performance obligation" can be adopted in the public sector, with some broadened characteristics as compared to the original IFRS 15.	develop an appropriate definition for a performance obligation for the public sector.
	At an overall level, we believe it is easier to assess a revenue transaction with specific recognition criteria in the public sector by focusing on requirements such as 1) non-exchange or exchange and 2) whether there is a performance obligation or not. We believe it is easier to assess if a revenue transaction has a performance obligation rather than considering if the stipulation in the agreement is a condition, as this adds complexity.	This is consistent with the draft comment letter. The Board has noted a framework based on the distinction between revenue transactions with performance obligations and those without performance obligations could result in fewer scope debates and more meaningful revenue recognition discussions.
	For example, in considering the revenue recognition of multi-period grants, an assessment should be made if the grant is an exchange or non-exchange. Normally grants are non-exchange as the grantor does not expect the same value in return. Next step for revenue recognition is assessing if there is a performance obligation which will be the driver of how the revenue is recognised either up front or over time. The challenge is in the definition of a performance obligation. We support how the IPSASB in the consultation paper defines a performance obligation. It should be distinct performance of either providing goods and/or services so that the revenue can be recognised as the performance obligation is satisfied. Distinct performance means "separately identifiable" in a binding arrangement between parties. For example a distinct performance is "a grant is received by a health clinic to provide vaccination to children in north Auckland" instead of "receiving a grant to fulfil the purpose of the clinic which includes vaccination of children".	This is consistent with the draft comment letter. Throughout the draft comment letter, the Board has emphasised that the PSPOA is appropriate only for transactions with performance obligations. This requires the transfer of resources to an external party in an enforceable and sufficiently specific agreement.
	Further to multi-year grant revenue which is normally provided by a grantor for the benefit of the public or third parties, we support the IPSASB consideration that in the public sector the revenue transaction is not just a two-party transaction. It could include a third party, for example, there could be a resource provider, resource recipient and beneficiaries. In this case, a performance obligation can be satisfied if the beneficiaries receive	This is consistent with the draft comment letter. The Board agreed that the PSPOA would be appropriate for transactions with three parties if the performance obligations are enforceable and specific.

R#	Comments	Staff response
	the distinct performance agreed between the resource provider and resource recipient.	We propose no amendments to the draft comment letter from R4's response.
R6	Yes, additional guidance is required – refer to SMC 1 response above.	Same comments as R2 above.
R7	Yes. If the IPSASB decides to progress Approach 1, then we consider further guidance is necessary in distinguishing between exchange and non-exchange transactions. The most difficult and time-consuming aspect of the transition to the new PBE Accounting Standards was assessing whether a revenue transaction was exchange or non-exchange due to the lack of guidance in this area. Further guidance on the exchange/non-exchange distinction would therefore be welcomed under Approach 1	Same comments as R2 above.

Preliminary View 4 (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.

R#	Comments	Staff response
R2	Yes, we agree with Preliminary View 4.	This is consistent with the draft comment letter.
R4	Yes, we support IPSASB's view to explicitly address "capital grants" in the IPSAS.	
R7	Yes, we agree that the accounting for capital grants should be explicitly addressed within IPSAS. We have encountered significant issues and challenges in accounting for capital grants received by entities in applying IPSAS 23. The IPSASB should also address capital grants from the funder's perspective.	

Specific Matter for Comment 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.

R#	**Comments**	**Staff response**
R2	We have not identified any other issues with capital grants and have no other proposals.	Noted.
R4	Auckland Council and the entities under Auckland Council Group receive capital grants for the ongoing infrastructure requirements in Auckland. Capital grants are part of Auckland Council's revenue streams and one of the biggest revenue streams for individual council-controlled organisations. We do not experience significant issues with revenue recognition of capital grants. Under the current standard, the Group recognises capital grants based on the infrastructure completed during the period since the grantor agrees to provide funding for infrastructure spent during the period. Every period, the entity receiving the funding (cash in arrears) recognises capital grant revenue to the extent of the infrastructure spend during the period. Generally, there is no agreed specific amount to be funded as capital grants and there is no condition to return the funding if the project fails.	This is consistent with the Board's proposed OCI approach where the OCI is recycled to surplus or deficit as the resources are used to construct the asset or when the asset is acquired as specified by the resource provider.
	However, we noted the issues being raised in the consultation paper such as exchange/non-exchange assessment and the time requirement consideration for multi-year capital grant. We believe that the recognition of capital grants is one example where "a performance obligation" approach can be applied; thus, we support IPSASB's proposal to explicitly address capital grants in the standard and align the revenue requirements for recognition with the proposed changes. We note that when there is an identifiable performance obligation, we are supportive of the "Public Sector Performance Obligation" approach.	The Board does not support the PSPOA for capital grants because there is no transfer of goods to an external party. The Board has proposed either a presentation approach or an OCI approach. We propose no amendments to the draft comment from R4's response.
R7	(a) Yes, the main issues we are aware of have been identified. (b) We are disappointed the IPSASB has not identified proposals for constituents to comment on.	Same comments as R4 above. The Board's proposed framework would cover capital grants as this is an expense transaction with no performance obligations but has stipulations over use. The outcome

R#	Comments	Staff response
	Our preference is for the IPSASB to develop proposed requirements and guidance for capital grant transactions based on application of the PSPOA. The proposals would need to address difficult capital grant issues, such as: • Where an entity has a use condition on an asset, and, if it breaches this condition, the grantor can request the return of the physical asset or refund all or part of the grant monies provided. For example, a capital grant provided that must be used to construct social housing and the asset must be used for social housing purposes for 20 years, and, if breached, all or part of the grant monies are repayable to the transferor. • A use condition is attached to an asset with an indefinite life and the asset must be returned to the transferor if that condition is breached. For example, land held that must be used indefinitely for agricultural use. We encourage the IPSASB to consider the capital grant requirements and guidance developed by the Australian Accounting Standards Board in AASB 1058 *Income of Not-for-Profit Entities*, in particular paragraphs 15 to 17, and illustrative examples 9 and 10. Requirements and guidance for entities that provide capital grants should also be considered by the IPSASB as it develops the non-exchange expense accounting proposals as providers of capital grants are faced with similar accounting issues as grant recipients.	under the Board's proposed OCI approach is similar to AASB 1058, in that revenue is recognised as and when the asset is constructed or acquired. The difference is that the OCI approach recognises the initial inflow of resources in OCI rather than on the balance sheet. The Board's proposed framework for the recognition of expenses would cover capital grants provided by the resource provider. We propose no amendments to the draft comment from R7's response.

Specific Matter for Comment 6 (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.

<table>
<tr><th>R#</th><th>Comments</th><th>Staff response</th></tr>
<tr><td>R2</td><td>We believe that the IPSASB should follow approach (b). However, significant guidance (including relevant illustrative examples) will need to be provided to assist preparers with determining whether measurement can be made such that the qualitative characteristics are achieved.

This is an area where we have seen significant divergence in practice, which is not desirable.

In particular we have seen divergence in the accounting treatment of items such as:
• peppercorn leases;
• loans of artwork for a set period for no consideration;
• secretarial services; and
• accounting services.
which can lead to significantly different accounting results for similar entities.</td><td>The cost would likely outweigh the benefits if the requirements for services in-kind were mandated. In the draft comment letter, the Board has noted that the IPSASB could consider mandating the disclosures of services in-kind. This is one way to improve the financial reporting in this area.

The IPSASB is considering peppercorn leases in its current project on leases. The leases ED is expected to be approved for issue at the IPSASB December 2017 meeting.

We propose no amendments to the draft comment letter from R2’s response.</td></tr>
<tr><td>R4</td><td>We support IPSASB’s option (a) above. We do not have material services in-kind received at Auckland Council Group, however, we are of the view that services in-kind should be assess carefully by the entity if there is value in recognition or the constraints under the Conceptual Framework are more prevalent (materiality, cost-benefit, balance between relevance, timeliness, verifiability, etc).

Auckland Council performs accounting services for other related trusts and entities, such as the Independent Maori Statutory Board and other Reserve Boards. There are services Auckland Council provides in-kind to these entities such as IT services, accounting services, and human resources etc. We believe that quantifying these services (and then expensing them) doesn’t add much value to these respective financial statements unless the amounts are material. Under the new standard, if the services they received are material to the readers, these can be disclosed in their financial statements and this option is welcomed by the preparers.</td><td>This is consistent with the draft comment letter.</td></tr>
<tr><td>R7</td><td>We support retaining the existing requirements that permit entities to make an accounting policy choice for the recognition of services in-kind.

In the public sector, most entities do not recognise services-in kind received. We are not aware of any</td><td>This is consistent with the draft comment letter.</td></tr>
</table>

R#	Comments	Staff response
	concerns by public sector entities about the existing service-in kind accounting requirements. We expect, in most cases, the cost of obtaining information on the value of services-in kind received would outweigh the benefits received from reporting this information. Mandating the recognition of services-in kind would require entities to establish systems and processes to gather reliable information, such as establishing time sheeting systems, systems to estimate the value of the services received, and internal controls over these to ensure the information is reliable and auditable. Preparers are also unlikely to see any significant benefits associated with the time and cost of establishing and maintaining service-in kind systems. For example, mandating the recognition of services-in kind may require schools to estimate a monetary value for members of the community who “donate” their time to various school activities, such as coaching, fundraising, working-bee activities, and other activities of the school. Additionally, we anticipate there could be difficulty in determining whether an entity has sufficient control for accounting purposes over an individual in assessing whether an asset arises from the services-in kind received.	

Preliminary View 5 (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.

R#	Comments	Staff response
R2	Our clients have limited exposure to non-exchange transactions. The Extended Obligating Event Approach is complex and significant education will be required to assist preparers with compliance therewith.	The draft comment letter notes that the Board does not support the EOEA for universally accessible services and collective services.
	From a New Zealand perspective, we would need more guidance on the likely impact of these requirements (if any) on the not-for profit sector if the IPSASB’s proposals are adopted. Significant additional guidance will be required in the not-for-profit sector for non-exchange transactions.	We can assess the impact when the IPSASB develops its ED.

R#	Comments	Staff response
	Although we can see benefit, in principal, the IPSASB's preliminary view, we question whether preparers will encounter difficulty in differentiating between exchange and non-exchange expenditure, as they currently do for exchange and non-exchange revenue. We also question whether a better distinction re accounting treatment should rather be based on whether there is an ongoing performance obligation or not.	This is consistent with the draft comment letter. The Board does not support the development of a standard for only non-exchange expenses. The Board's proposed framework would distinguish between expense transactions with performance obligations and those without performance obligations. We propose no amendments to the draft comment letter from R2's response.
R4	We believe that the recognition of expenses should be simplified and should not include significant judgement. In the public sector, there are plans (long-term plan, annual plan, etc) required by the legislation for local government to complete or appropriations for the national government.	The Board has encouraged the IPSASB to apply a consistent approach for expenses with similar characteristics such as social benefits, universally accessible services and collective services.
	In Auckland Council Group, the plans for collective services are commonly approved by the various committees or leaders and are announced to the public. These create expectations and can be considered or assessed as non-legally binding which in our view should not create a liability. However, these plans may change which driven by a change in leadership/political leaders or availability of funding.	A liability can arise from a non-legally binding obligation. The Conceptual Framework notes that sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.[7]
	The added consideration for non-legally binding obligations under "The Extended Obligating Event" approach creates a difficult judgement exercise for public sector entities. The public sector entity is only certain that these expenses are incurred when the entity entered into a legally binding agreement or the money has been disbursed. The universally accessible services and collective services with no performance obligations should just be simply recognised as incurred.	This is broadly consistent with the Board's proposed OEA. We propose no amendments to the draft comment letter from R4's response.
R6	R6 provided no response to PV 5, PV 6 and PV 7. General comments were provided for expense recognition as follows. There is merit in a matching principle, depending on the outcome of conclusions on revenue recognition. Having	The Board does not support the matching principle unless there is a conceptual rationale. The Board has looked at the expense from a balance sheet perspective.

[7] Conceptual Framework, para 5.22

R#	Comments	Staff response
	said that, the basic concept that expenses are recognised as incurred is simple, easy to apply and consistent with the underlying framework.	The expense is recognised when the obligating event occurs (i.e. the definition of a liability is satisfied). We propose no amendments to the draft comment letter from R6's response.
R7	The CP acknowledges that universally accessible services and collective services contain no performance obligations or stipulations that the resource recipient is required to fulfil as a result of receiving these services. Given there are no performance obligations on service recipients, there appears to be little merit in considering application of an extended obligating event approach. We consider the important issue for the IPSASB to address is the liability recognition point for universally accessible and collective services as this drives the expense recognition.	This is consistent with the draft comment letter.

Preliminary View 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.

R#	Comments	Staff response
R2	Please refer to out comment under Preliminary View 5.	This is consistent with the draft comment letter.
R4	We agree with this view as this is consistent with how revenue is being recognised if there is no condition or performance obligation.	The draft comment letter notes that the Board does not agree with the rationale provided for PV 6. We propose no amendments to the draft comment letter from R4's response.
R7	While we are comfortable with the accounting outcome of universally accessible services and collective services liabilities and expenses being recognised when incurred, the IPSASB needs to provide further reasons and analysis to support this conclusion. The CP justifies there is no obligating event in relation to universally accessible services and collective services because governments can vary the level of such services	This is consistent with the draft comment letter.

R#	Comments	Staff response
	so that the availability of those services may be limited. We do not think this fact is persuasive in its own right to support the conclusion reached. We note that adjusting the levels of services provided by a government is unlikely to occur swiftly and may require legislative change for rights to services established through legislation. The IPSASB should consider the work in the Social Benefits project to strengthen the support for the PV.	

Preliminary View 7 (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.

R#	Comments	Staff response
R2	Please refer to our comment under Preliminary View 5.	See staff response under PV 5.
R4	Those non-exchange expenses with performance obligations should also be accounted for consistently with how the revenue with the same performance obligations is accounted for. This is consistent with the PSPOA approach	This is consistent with the draft comment letter.
R7	We generally agree with this PV. However, we consider: • The performance obligation definition needs to be broader than proposed by the IPSASB, for the same reasons as explained in SMC 2 above. • The IPSASB also considers time-requirements and capital grant accounting for grant providers, as noted in PV 4 and SMC 3 above. We also consider that sufficient guidance needs to be provided on the liability recognition point for all grants, contributions, and other transfers (regardless of the approach applied to expense recognition). An issue often encountered in practice with these arrangements is when a present obligation to provide funding arises. Particularly, when grant funds are paid over time and future payments are conditional on the grantee performing an action or reaching a specified milestone.	This is broadly consistent with the draft comment letter. The Board has noted that the PSPOA is appropriate only for expenses with performance obligations. The Board has considered broadening the PSPOA for expense transactions with no performance obligations but with stipulations and enforcement mechanisms, but deferral of the expense was dismissed because it does not satisfy the definitions of elements in the Conceptual Framework. Under the Board's proposed framework, the Board has considered the accounting implication for the timing of payments.

R#	Comments	Staff response
		We propose no amendments to the draft comment letter from R7's response.

Preliminary View 8 (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.

R#	Comments	Staff response
R2	Yes, we agree with Preliminary View 8.	This is consistent with the response for statutory receivables in the draft comment letter.
R4	We are supportive of the preliminary view of the IPSASB on non-contractual receivables. The legislated amount or face (nominal) value, which often equals to fair value of the transaction demands accountability for management. We agree with the proponents of this option (as stated in the consultation paper) that non-contractual receivables such as receivables from rates for Auckland Council is of public interest and therefore the elected officials and the management should be accountable to report this information to the public, who are also readers of the annual report. With this option, entities such as the Auckland Council Group are able to present the gross amount of the legislated rates and present any further reductions such as impairment. The preparers of the annual report can also present the movement from prior year of both the rates receivables and impairment which can improve the understanding of the readers/users of the annual report.	
R7	Yes, we agree. The initial measurement of statutory receivables, such as taxes and fines, at fair value was subject to significant debate between some preparers and auditors on transition to IPSAS 23. In particular, there was tension between the requirements of IPSAS 23 and concerns over the loss of important information on statutory imposed revenue amounts by applying a fair value measurement approach at initial recognition. Initially recognising non-contractual receivables at face value with a separate impairment amount would help	

R#	Comments	Staff response
	provide greater transparency and accountability for statutory-based revenues.	

Preliminary View 9 (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.

R#	Comments	Staff response
R2	Yes, we agree with Preliminary View 9.	This is consistent with the response for statutory receivables in the draft comment letter.
R4	We recognise the difficulty of the applying fair value approach to our ordinary receivables. The non-contractual receivables of the Auckland Council Group may include those arising from rates, fines, penalties, etc. Since these receivables are already considered non-contractual determining the market interest rate at each reporting date to calculate the fair value is a challenge. Identifying similar financial instruments with the same terms and risk profile is also a challenge as receivables from revenue transactions arising from legislative power is not common in the market. We believe that it is easier to adopt the "cost approach" or lower of carrying value and recoverable amount. We support the consultation paper's assessed advantage of avoiding what are likely to be potentially arbitrary decision on market interest rates. On the other hand, the preparers are still able to use the "discounting of cash flows" and assessment of proper interest rates in determining the recoverable amount. The cost approach doesn't add too much complexity in determining the subsequent measurement of simple receivables such as licenses, fines and penalties, etc.	If the cost approach is used, an impairment assessment is still required because the subsequent measurement is at the lower of cost and recoverable amount. We propose no amendments to the draft comment letter from R4's response.
R7	Yes, we agree. We favour this approach over amortised cost and cost as it should generally be the simplest of the 3 proposed methods to apply in practice. Entities that hold non-contractual receivables often have a large number of debtors with small amounts in the context of the overall portfolio balance. These portfolios are not managed based on credit risks and therefore have different characteristics to commercial receivable portfolios.	This is consistent with the response for statutory receivables in the draft comment letter. We propose no amendments to the draft comment letter from R7's response.

R#	Comments	Staff response
	We anticipate it would be unduly complex and costly to apply the amortised cost approach to large statutory receivables portfolios where discounting is required. It may also be unworkable to apply the IFRS 9 expected credit loss impairment model without practical expedients given the large volume and the nature of statutory receivables. The cost approach also seems problematic as it would be difficult to determine when a debtor is impaired or when a past impairment is reversed within a large portfolio. While there could be more volatility in the statement of financial performance arising from discount rate changes under a fair value approach, this does not seem to have been a significant issue for those New Zealand entities that have applied a subsequent measurement model that is similar to fair value.	

Specific Matter for Comment 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.

R#	Comments	Staff response
R2	We support (a) as this approach will be relatively straight forward to apply.	The draft comment letter noted that the Board initially supports the IPSAS 19 requirements for the subsequent measurement of non-contractual payables. The Board has previously noted that the IPSAS 19 requirements are consistent with the cost of fulfilment approach. We propose no amendments to the draft comment letter from R2 and R4's responses.
R4	We believe that it would be easier to apply the Cost of Fulfilment approach as it requires a best estimate of the amount required to settle the liability, using the discounted cash flows approach where appropriate. It is also consistent with the requirements of IPSAS 19 which is the best estimate of the expenditure required to settle the present obligation at reporting date which also considers the time value of money.	

R#	Comments	Staff response
R7	We prefer the IPSAS 19 approach as that approach appears to more closely align to the fair value approach for non-contractual receivables. The CP is unclear on what the practical difference is between the cost of fulfilment approach and the IPSAS 19 approach above as both approaches are based on discounted cash outflows. If the IPSASB considers there is a practical difference between approaches (a) and (d) above, it would be helpful for that to be explained in the future exposure draft if different options are being considered. Our preference is to follow an approach that closely aligns with the subsequent measurement requirements of non-contractual receivables. Different subsequent measurement approaches between receivables and payables is likely to be confusing for preparers and users of financial statements and could require different systems. This is likely to be a concern for entities that report both non-contractual receivables and payables for the same tax. For example, the Inland Revenue Department and Financial Statements of Government report both tax related receivables and payables in the statement of financial position as the Government can owe and be owed amounts related to income tax and GST (and the position of the respective taxpayers could change year-on-year). We think there would need to be a compelling reason to apply different subsequent measurement bases for non-contractual receivables and payables.	This is consistent with the draft comment letter. The Board has recommended that the IPSASB first establish the recognition approaches for revenue and non-exchange expenses. This will then drive the appropriate measurement. We propose no amendments to the draft comment letter from R7's response.

NZ ACCOUNTING STANDARDS BOARD

XX January 2018

Mr John Stanford
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto
Ontario M5V 3H2
CANADA
Submitted to: www.ifac.org

Dear John

Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

Thank you for the opportunity to comment on Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (the CP). The CP has been exposed in New Zealand and some New Zealand constituents may have made comments directly to you.

The New Zealand Accounting Standards Board (NZASB) is pleased the IPSASB has made progress on the project for revenue and non-exchange expenses. Both are major topics in the public sector and in our not-for-profit (NFP) sector who apply IPSAS-based standards.

The limited comment period for such broad and important topics has meant we could focus only on the most significant issues. For this reason, some of our responses are at a high level only.

The NZASB has considered the CP and, while supportive of the overall project and some aspects of the proposals, is of the view that the CP has not addressed a number of issues. Our main comments are as follows.

Revenue

- In order to develop our responses to the CP and provide our views on the treatment of various types of revenue transactions, we have developed a proposed framework for the recognition of revenue transactions in the public sector. This proposed framework distinguishes between revenue transactions with performance obligations and those without performance obligations, rather than using the exchange or non-exchange distinction.

- We agree that revenue transactions with performance obligations should be accounted for using the Public Sector Performance Obligation Approach (PSPOA), which is based on IFRS 15 *Revenue from Contracts with Customers* adapted for the public sector.

- We agree that revenue transactions with no performance obligations or stipulations should be accounted for under a residual revenue standard (or a residual section of the standard, if there is only one standard on revenue), based on the applicable parts of IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* and updated to address issues relating to these types of transactions.

- We do not agree with the CP's proposal to apply the PSPOA for revenue transactions with no performance obligations but with stipulations over use. Instead, these revenue transactions should be recognised when the resource recipient has control of the resources transferred. We have suggested two options for presenting information about revenue arising from these transactions to highlight stipulations over the use of resources received. These options could help to resolve the problem of explaining the resource recipient's performance story and at the same time provide a faithful representation of the resource recipient's financial position.

  We consider that this approach is consistent with the definitions of elements in the IPSASB's *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework).

- A significant amount of work is still required for the range of transactions not covered in the CP, such as revenue transactions without performance obligations but with other stipulations over use rather than just time requirements.

Non-exchange expenses

- The proposed approaches for the recognition of non-exchange expenses in the CP appear to have been developed based on applying the proposed CP revenue recognition approaches in reverse (a mirror approach). However, we consider that the recognition of non-exchange expenses from a resource provider perspective should encompass a distinct set of considerations and recognition issues in contrast to the recognition of revenue by the resource recipient.

- The CP does not fully address the accounting for all types of non-exchange expense transactions and the related recognition issues that arise in the public sector. Some types of transactions are not discussed, such as expense transactions with no performance obligations but with various types of stipulations. In our opinion, for those transactions that are discussed in the CP, the analysis is insufficient, both in terms of the rationale provided and the consideration of alternative views.

- The CP's deficient analysis for non-exchange expenses has compelled us to do a lot of thinking on the range of expenses in the public sector and the appropriate recognition approaches. Similar to our proposed framework for the recognition of revenue, our proposed framework for the recognition of expenses is also based on the distinction between transactions that impose performance obligations on the resource recipient and those without performance obligations.

- We do not agree with the discussion of universally accessible services and collective services. We consider that there are no significant conceptual differences between the transactions in Exposure Draft 63 *Social Benefits* and universally accessible services and collective services and, therefore, the accounting for these expenses should be consistent and would require consideration of similar issues. We therefore encourage the IPSASB to consider how any decisions made in the development of standards-level requirements for social benefits would impact the development of an approach for recognising other expenses and liabilities arising from similar types of transactions, such as universally accessible services and collective services.

- We broadly agree with the PSPOA for expenses arising from transactions that impose performance obligations on the resource recipient. However, we do not support the use of an Extended Obligating Event Approach (EOEA) for other non-exchange expense transactions. We propose an alternative approach, the Obligating Event Approach (OEA).

- Under our proposed OEA, the first question to consider is when does an obligating event which leads to the recognition of a liability arise. The guidance on an obligating event can be drawn from the IPSASB's Conceptual Framework and IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. The second question to consider is when should a corresponding expense or asset be recognised. The expense would be recognised when the entity no longer has control over the resources transferred.

- We also recommend that the IPSASB considers two options for presenting information about expenses arising from transactions when there are stipulations (but not performance obligations) imposed on the resource recipient.

These points, together with our proposed frameworks for the recognition of revenue and non-exchange expenses, are discussed in Appendix 1 to this letter. The response to the Preliminary Views and Specific Matters for Comment are set out in Appendix 2 to this letter. If you have any queries or require clarification of any matters in this letter, please contact Aimy Luu Huynh (aimy.luuhuynh@xrb.govt.nz) or me.

Yours sincerely

Kimberley Crook

Chair – New Zealand Accounting Standards Board

APPENDIX 1 Overview of the NZASB's proposals

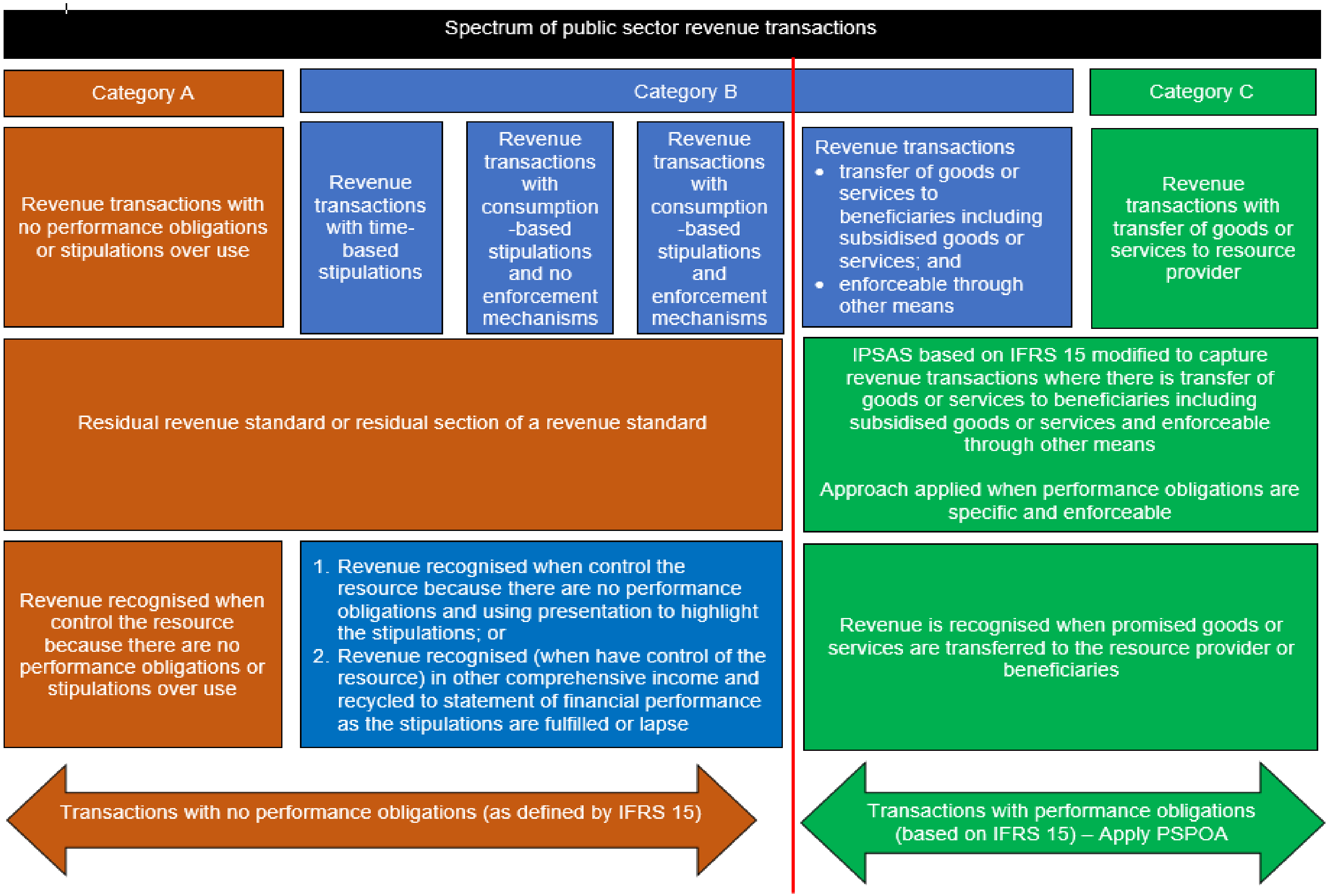
Revenue

The NZASB has considered the proposed revenue recognition approaches in the CP and is of the view that these proposals do not fully capture all the revenue transactions in the public sector or address all the revenue issues identified in the CP. The CP focuses on revenue transactions with performance obligations, or revenue transactions without performance obligations but with time requirements. There are a number of revenue transactions without performance obligations but with other stipulations which the CP has not considered (for example, revenue transactions with consumption-based stipulations, such as grants to fund the salary costs of a resource recipient).

The NZASB has developed a proposed framework for revenue transactions in the public sector which distinguishes between revenue transactions with performance obligations and those without performance obligations, rather than using the exchange or non-exchange distinction.

Diagram 1 below provides an overview of the NZASB's proposed framework for revenue transactions in the public sector.

Diagram 1 NZASB's proposed framework for revenue recognition



The CP has grouped revenue transactions into three categories (Categories A, B, and C) and these categories have been used to discuss the proposed revenue recognition options. However, there is a wide spectrum of revenue transactions in the public sector with varying forms of performance obligations and stipulations; therefore, establishing clear boundaries for when different revenue recognition approaches apply would be important for drafting exposure drafts (EDs) and standards. The boundary for different revenue recognition approaches would largely depend on how far the IFRS 15 concept of a "performance obligation" is stretched to reflect the public sector context.[1]

For revenue transactions with performance obligations, our proposed framework is based on the PSPOA. It is therefore based on IFRS 15, adapted for the public sector context, and stretched to include as many revenue transactions as feasible, subject to maintaining consistency with the definition of a liability in the Conceptual Framework. We have also sought to ensure that those transactions within the scope of the PSPOA are the types of transactions to which the revenue recognition model in IFRS 15 should be applied.

A framework based on a distinction between transactions with performance obligations or without performance obligations could result in fewer scope debates and more meaningful revenue recognition discussions, in contrast to the difficulties experienced applying the current exchange and non-exchange distinction.

We have explained our proposals for the three categories of revenue transactions in order of the Preliminary Views (PV) and Specific Matters for Comment (SMC) in the CP.

Category C

Transactions in our Category C are the same as proposed in the CP, being enforceable agreements with performance obligations to transfer goods or services to the resource provider. Therefore, we agree revenue transactions in Category C should be accounted for using the proposed PSPOA.

Category A

Transactions in our Category A are the same as proposed in the CP, being those with no performance obligations or stipulations. Under our proposed framework, these transactions would be accounted for in a residual revenue standard (or residual section of a revenue standard), based on the applicable parts of IPSAS 23 and updated to address practice issues relating to these types of transactions, as discussed further in our response to PV 2 and SMC 1.

---

[1] For the purpose of this comment letter, we have developed a working definition of a public sector performance obligation. Our proposed definition is:

an enforceable agreement with the resource recipient to deliver specific goods or services either to the resource provider or to beneficiaries.

Category B

There is a wide spectrum of revenue transactions in Category B. The scope of Category B transactions that could be accounted for using the PSPOA would depend on how the IPSASB defines key factors such as enforceability and performance obligations.

Our view of performance obligations requires the transfer of resources to an external party in an enforceable and sufficiently specific agreement. This is not the same as IPSAS 23's broad notion of a performance obligation, being a duty to act or perform in a certain way. Our proposed framework is based on the definition of a liability in the Conceptual Framework, whereby for a liability to exist, the obligation must require an outflow of resources. Hence, our proposed framework would remove the current distinction between conditions and restrictions as such a distinction would not be relevant and is not helpful. In addition to the issues experienced with the exchange or non-exchange distinction, our constituents have also experienced issues with classifying stipulations as either conditions or restrictions.

Under our proposed framework, arrangements with consumption-based stipulations, either with or without return conditions (and/or other enforcement mechanisms), would not result in a deferral of revenue as using resources internally does not involve an outflow of resources. In other words, a deferral of revenue would arise if there is an enforceable and specific agreement to transfer goods or services to external parties, including beneficiaries, i.e. there are performance obligations as defined under the PSPOA. Thus, revenue would be deferred only if there is an obligation that satisfies the definition of a liability.

<u>Transactions currently in IPSAS 23</u>

We have identified transactions which currently fall within the scope of IPSAS 23 that should be accounted for using the PSPOA if they have performance obligations and the following characteristics.

- Enforceable through other means

  We agree with the CP's view that enforceability in a binding arrangement would need to go beyond the existence of a return obligation and include other enforcement mechanisms where the transferor can take remedies in the event of non-fulfilment of a performance obligation. An enforceable binding arrangement can be enforced through legal or equivalent means.

  Therefore, some transactions with no explicit return condition, but which are enforceable through other means, should be accounted for under the PSPOA. We comment further on this point in our response to PV 1.

- Transfer of goods or services to beneficiaries

  Based on the current IPSAS literature, one interpretation of the definition of exchange and non-exchange transactions is that where the transfer of goods or services is to a beneficiary (rather than the resource provider), the transaction is a non-exchange transaction. There is no exchange of approximately equal value between the resource recipient and the resource provider.

Consistent with our earlier comments about the definition of a liability, it should not matter whether the resource recipient is required to transfer goods or services back to the resource provider or to beneficiaries – either way, there is a transfer of resources to an external party. We consider that the PSPOA should capture revenue transactions arising from three party arrangements (resource provider, resource recipient and resource beneficiary).

Therefore, we agree with the CP that revenue transactions in Category B where the goods or services are transferred to beneficiaries should be accounted for using the PSPOA.

- Subsidised goods or services

  Again, consistent with our earlier comments about the definition of a liability, it should not matter whether the arrangement involves the transfer of goods or services at a subsidised price – irrespective of whether a price subsidy exists, a performance obligation exists when the resource recipient is obliged to transfer goods or services to an external party.

  Therefore, transactions that transfer goods or services to beneficiaries with a subsidy or a cost-recovery basis should be accounted for under the PSPOA.

Other issues for consideration

There is a range of issues that would need to be addressed in developing the PSPOA. These are discussed in our response to PV 1 and SMC 2.

Transactions with consumption-based stipulations and enforcement mechanisms

The NZASB is aware of the different views on the appropriate recognition of revenue for transactions with consumption-based stipulations with return obligations and/or other enforcement mechanisms. We considered whether a broader notion of "performance obligation" should be applied (similar to the IPSAS 23 notion of performance obligation, as noted above). For this category of transactions, the resource recipient has specific and enforceable obligations to use the resources in the manner specified. However, satisfying those "obligations" does not result in an outflow of resources as the funds received would be spent on acquiring resources for the entity itself, rather than transferring goods or services to other external parties, so a liability does not exist.

For example, a medical practice receives funding for the salary of its office manager. The office manager is not directly involved in the provision of the health services to the patients. The office manager does the administration and support services so is only indirectly involved in the provision of the health services to the patients. The funding of the office manager's salary does not impose on the entity an obligation to transfer resources to an external party, so a liability does not exist. Rather, the stipulation on how the resources must be used requires the resource recipient to exchange one type of resource (the funds received from the resource provider) for another type of resource (employee services), i.e. an exchange of assets.

In reaching this conclusion, we considered the argument that although the resource provider is funding the inputs of the resource recipient rather than its outputs, the only reason for funding those inputs is so that the resource recipient can deliver the outputs. It could be argued that, in effect, the resource provider is funding the delivery of goods or services, similar to transactions in which the resource provider directly funds the delivery of those goods or services. However, we note that this argument also could be applied to other forms of funding, including funding in which there are no specific stipulations, as ultimately all funding provided to public sector entities is intended for the purpose of enabling the resource recipient to deliver goods or services to beneficiaries. Hence, if followed to its logical conclusion, this argument would mean that all funding received would be recorded as a liability until ultimately spent or consumed in the delivery of goods or services.

Nevertheless, for this category of transactions, we acknowledge that the Conceptual Framework's discussion of "other obligations" could be applicable – although these transactions do not impose obligations on the resource recipient that meet the definition of a liability, there are "obligations" in the broader sense. Even though the liability definition is not satisfied, some might argue that deferral of revenue recognition could be justified under the "other obligations" approach. We also acknowledge the challenges for the resource recipient in telling their performance story if revenue is recognised before the funding is spent on satisfying those stipulations. However, on balance, we concluded that it is not appropriate to defer revenue and report either a liability or "other obligation" in the statement of financial position when no liability exists, as that does not faithfully represent the recipient's financial position.

For this reason, we recommend exploring the presentation and OCI options (discussed below) to provide further information about revenue arising from transactions that impose stipulations (but not performance obligations) on the resource recipient, as proposed under our framework. In our view, these options could help to resolve the problem of explaining the recipient's performance story, while also faithfully representing the recipient's financial position.

<u>Transactions with consumption-based stipulations but without enforcement mechanisms</u>

We consider transactions with consumption-based stipulations (i.e. stipulations on the use of the funds), but without return obligations or other enforcement mechanisms, to be substantially the same as transactions with a time requirement (discussed below) – there may be a restriction on how the funds are spent but there is no obligation to transfer resources to an external party (so no liability exists). However, the existence of the stipulation results in similar issues as for transactions with time-based stipulations, and hence a similar accounting treatment should apply.

<u>Transactions with time-based stipulations</u>

For revenue transactions with no performance obligations or stipulations over use, other than time requirements, the restriction on the timing on when the funds are used does not impose on the entity an obligation to transfer resources to an external party, so no liability exists. Also, as discussed above in the context of other transactions with consumption-based stipulations and in our response to SMC 3, we do not support an approach that would treat these stipulations as "other obligations" in the statement of financial position.

<u>Presentation of revenue arising from transactions with stipulations</u>

To provide further information about revenue arising in transactions with stipulations (but not performance obligations), including transactions with time-based stipulations, we considered two options which could be appropriate. We explain these two options below. Later, we provide our views on our preferred option.

1. Presentation

   This option is the same as Approach 1 "The Exchange/Non-Exchange – Update IPSAS 23", option (b) proposed in the CP. Revenue is recognised when resources are received or receivable, but with enhanced presentation to highlight the stipulations over use (either when or how the funds must be used). This option stays true to the definitions of elements in the Conceptual Framework and gives the resource recipient a method of communicating its performance story to the users of financial statements. This option would help to educate users to focus not only on the surplus or deficit (the "bottom line") but to look at what makes up the surplus or deficit.

   We have provided additional comments on how this presentation option could be applied in our response to SMC 3.

2. Other comprehensive income

   This option is an extension of Approach 1, option (e) proposed in the CP. Our option would require the IPSASB to develop principles for presenting revenue and expenses outside of surplus or deficit, similar to the presentation of other comprehensive income (OCI) in IFRS® Standards (for the reasons explained below). This option would be appropriate only for transactions where there are resources with clear stipulations imposed by the resource provider. This is because the stipulations need to be sufficiently clear to enable the resource recipient to determine when the stipulation has been fulfilled or has lapsed. Also, we do not consider it appropriate to apply this approach to self-imposed stipulations on the use of funds.

   On initial recognition, the recipient would recognise the inflow of resources in the OCI section within the statement of financial performance and then take those resources to a separate reserve within net assets/equity. As the resources are used (either over the specified time, in the case of time-based stipulations, or in the manner specified, in the case of consumption-based stipulations), the amount initially reported in OCI is recycled to revenue. Our suite of PBE Standards already has the concept of OCI, which we refer to as "other comprehensive revenue and expense". Before introducing our suite of PBE Standards based on IPSAS, our public sector entities had previously applied New Zealand equivalents to IFRS Standards, including OCI, so we carried forward OCI into our suite of PBE Standards.

   This option keeps the balance sheet consistent with the definitions of elements in the Conceptual Framework. The resources would still be recognised in the statement of financial performance when received or receivable but through a separate section called OCI or an equivalent.

   This option overcomes the strict principle in IPSAS 23, which does not permit revenue from the receipt of resources with no conditions to be recognised at the time when the stipulations are fulfilled or lapse. This option acknowledges the stipulations placed on the resources as this is shown clearly in the statement of financial performance and is more likely to result in revenue being included in surplus or deficit in the same periods in which the resources are used.

This option would work only if the IPSASB introduces OCI into the IPSAS literature. This option would require the IPSASB to develop principles for what should be recognised in OCI. This option would not work if the resources are recognised directly in net assets/equity. If the resources are recognised directly in net assets/equity, this is less transparent and potentially misleading, as it is presenting a message that the recipient has not benefited from receiving the resources, which does not reflect the substance of the transaction.

In considering this option, we thought about transactions in which the resource recipient is required to use the funds received for the acquisition or construction of property, plant or equipment (i.e. capital grants), including situations in which there is an ongoing or permanent restriction on the use of these assets, such as land that must continue to be used for a purpose specified by the resource provider. Under this OCI option, the resources received for the acquisition or construction of assets would be recognised in OCI initially and subsequently recycled to surplus or deficit as they are spent on acquiring or constructing the specified asset. We consider that the stipulations on resources provided for the acquisition or construction of assets are largely fulfilled when the resources are spent in the manner specified by the resource provider. We consider that the on-going requirement to use the asset for the specified purpose to be in the nature of a restriction on assets, which should be disclosed in the notes to the financial statements.

<u>Our preference on whether to use the presentation option or OCI option</u>

In suggesting the presentation option and OCI option, the NZASB notes that there are issues in practice in providing users of financial statements with a clear picture of the resource recipient's performance for a particular period in situations in which the entity has received funding with stipulations attached. Hence, the NZASB considered how to present revenue arising from such funding in a way that assists the resource recipient in telling its performance story, but without creating new problems associated with deferring revenue in the statement of financial position when no liability exists.

The majority of NZASB members prefer the presentation option, with a minority preferring the OCI option. In addition, some NZASB members that prefer the presentation option would also accept the OCI option if there are significant difficulties in developing the presentation option.

Non-exchange expenses

Introduction

The NZASB has considered the CP's proposed approaches for the recognition of non-exchange expense and is of the view the proposals do not fully address the accounting for all types of non-exchange expense transactions and the related recognition issues that arise in the public sector. Some types of non-exchange expenses transactions are not discussed. In our view, for those types of transactions that are discussed, the analysis is insufficient, both in terms of the rationale provided and the consideration of alternative approaches.

We first explain our concerns with the proposals in the CP and then our proposed approach.

The proposed approaches for the recognition of non-exchange expenses in the CP appear to have been developed based on applying the proposed CP revenue recognition approaches in reverse (a mirror approach). We note the IPSASB is of the view that it is important for the approach in a non-exchange expense standard for grants, contributions, and other transfers to mirror the approach adopted for an equivalent revenue transaction.[2]

Although we agree that it is important to be consistent when dealing with similar accounting issues (which we comment on further later), that does not mean that a conclusion reached in one context applies in a different context.

The recognition of non-exchange expenses from a resource provider context should encompass a distinct set of considerations and recognition issues in contrast to the recognition of revenue by the resource recipient. The key issues discussed in the CP relating to the recognition of revenue are primarily concerned with determining when revenue should be recognised, once it has already been established that the resource recipient has received or is entitled to receive the funding concerned. In contrast, the key issues relating to the recognition of non-exchange expenses are primarily concerned with determining when the resource provider has incurred a liability to transfer resources to another party, which involves identifying when the resource provider has a present obligation arising from a past event. Furthermore, it cannot be assumed that the pattern of revenue recognition by the resource recipient should mirror the pattern of expense recognition by the resource provider.

We therefore consider that applying a mirror approach is not an appropriate starting point for developing a framework for non-exchange expense recognition. Nevertheless, once an approach for non-exchange expense recognition has been developed from the context of the resource provider, in our view it would be useful for the IPSASB to consider whether there is consistency between the proposed revenue and non-exchange expense recognition approaches. This ensures that any differences in outcomes can be explained and reflect the different circumstances in each case, rather than any inconsistency in the conceptual rationale for conclusions reached on similar or related issues. The differences in recognition outcomes are also important for consolidation purposes when the group has both the resource provider and resource recipient. The resource provider may have recognised the expense and liability but the resource recipient may not have recognised the

[2] Paragraph 6.42 of the CP

corresponding revenue and asset. If the IPSASB develops technically robust revenue and non-exchange expense recognition approaches, the differences would be justifiable from a conceptual basis.

We also note that the CP discussion on the recognition of non-exchange expenses in relation to transactions with no performance obligations focuses mainly on the accounting for universally accessible services and collective services. It is not clear how the CP proposes to account for other non-exchange expense transactions in which the resource provider has imposed stipulations (but no performance obligations), such as stipulations on when the funding must be spent (time restrictions) or other restrictions or conditions over use.

Furthermore, we note PV 7 states that the IPSASB is of the view that a PSPOA for non-exchange expense transactions should be applied to grants, contributions and other transfers which contain either performance obligations or stipulations. There is limited discussion on why the IPSASB considers that a PSPOA is appropriate for non-exchange expense transactions with stipulations over use but no performance obligations, and how a PSPOA would be applied to these transactions with no performance obligations.

We consider that additional standards-level requirements are needed to provide guidance on determining when the obligating event that leads to liability and expense recognition arises for the wide range of non-exchange expense transactions that occur in the public sector.

For these reasons, and others as discussed below and in our response to SMCs and PVs, we feel that further analysis and discussion of a range of issues relating to non-exchange expense recognition is necessary to develop guidance on these matters.

NZASB's proposed framework for expense recognition

The NZASB has developed a proposed framework for the recognition of various types of expenses in the public sector that appear to be in the scope of the CP.

Under this proposed framework for expense recognition, we do not support the development of a standard for non-exchange expenses only. This would result in the creation of an arbitrary distinction between exchange and non-exchange expenses, which already has been problematic in the context of revenue. Instead, we suggest the IPSASB considers developing a simplified PSPOA for all expense transactions with performance obligations, excluding expense transactions that already have specific standard-level requirements.[3]

Similar to our proposed approach for revenue recognition, our proposed framework for expense recognition is primarily based on the distinction between those expense transactions where the resource provider imposes on the resource recipient performance obligations and those without performance obligations.

[3] For example, IPSAS 13 *Leases* and IPSAS 39 *Employee Benefits*

The NZASB's proposed framework for expense recognition is based on two broad categories of transactions:

(a) For all transactions where the resource provider imposes on the resource recipient performance obligations[4] , we propose applying a PSPOA for expenses (simplified).

We do not envisage a full five-step recognition model, as proposed under the PSPOA for revenue, is required for expense recognition. Instead we propose a simplified approach based on the recognition of expenses when the specified goods or services are transferred to the agreed beneficiaries.

(b) For other expense transactions, we propose the IPSASB develop an expense recognition approach based on the Conceptual Framework's definition of a liability and the principles and guidance in IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* to determine when the obligating event arises in different circumstances. Henceforth, we refer to this approach as the "Obligating Event Approach" (OEA).

Under this approach, expenses would be recognised when the obligating event arises (i.e. when the definition of a liability is met). In certain circumstances, the timing of expense recognition would be impacted by whether a payment is made before or after an obligating event has occurred. Expenses may be recognised earlier when prepaid (when the resource provider no longer has control over the resources transferred).

Key differences in proposed framework for non-exchange expense recognition

The CP has proposed an EOEA for all non-exchange expense transactions (excluding social benefits) with no performance obligations or stipulations, and a PSPOA for all other transactions with performance obligations or stipulations.

In contrast, the NZASB's framework proposes an OEA – without any "extension" (as explained further below) – for all expense transactions (excluding social benefits) with no performance obligations, and a PSPOA for all other expense transactions involving an outflow of resources in situations where there are performance obligations imposed on the resource recipient.

NZASB's proposed Obligating Event Approach

The OEA is proposed by the NZASB as an alternative to the EOEA described in PV 5 of the CP. The OEA is an approach for expense recognition based on the Conceptual Framework's definition of a liability, and further guidance in IPSAS 19 for obligations of uncertain timing or amount at the reporting date.

Under the OEA, a liability and corresponding expense is recognised when the obligating event arises. The key determinant for liability and expense recognition is whether there is an obligating event –

[4] Transactions involving an outflow of resources from the resource provider and impose on the resource recipient one or more obligations to transfer goods or services, either to the resource provider or to beneficiaries. As discussed in our proposed framework for revenue recognition, these obligations need to be enforceable and sufficiently specific to represent performance obligations.

that is an event that creates a legal obligation or non-legally binding obligation that results in the resource provider having no realistic alternative to avoid settling that obligation.

The EOEA proposed by the CP also includes the concept of a liability in the Conceptual Framework and includes consideration of when the obligating event arises. However, the key determinant for liability and expense recognition under this approach is based on whether the resource provider retains control of the resources transferred. This approach is based on IPSAS 23 in reverse, with the recognition of an asset (rather than an expense) based on whether the resource recipient is required to satisfy any stipulations in the form of restrictions over use or conditions requiring the return of the resources.

The NZASB does not support the use of an EOEA because it:

(a) uses a model developed for revenue rather than expenses;

(b) requires the retention of the exchange/non-exchange distinction (consistent with our proposed revenue recognition approach, we also propose moving away from this distinction for expenses);

(c) requires judgement to determine if a stipulation is a condition or a restriction, which may lead to the recognition of an asset rather than an expense when resources are transferred to a resource recipient (our constituents have also experienced issues with this classification as noted earlier); and

(d) is not based on a robust rationale for why the existence of conditions not yet fulfilled leads to the conclusion that an asset exists from the perspective of the resource provider when resources have been transferred to the resource recipient.

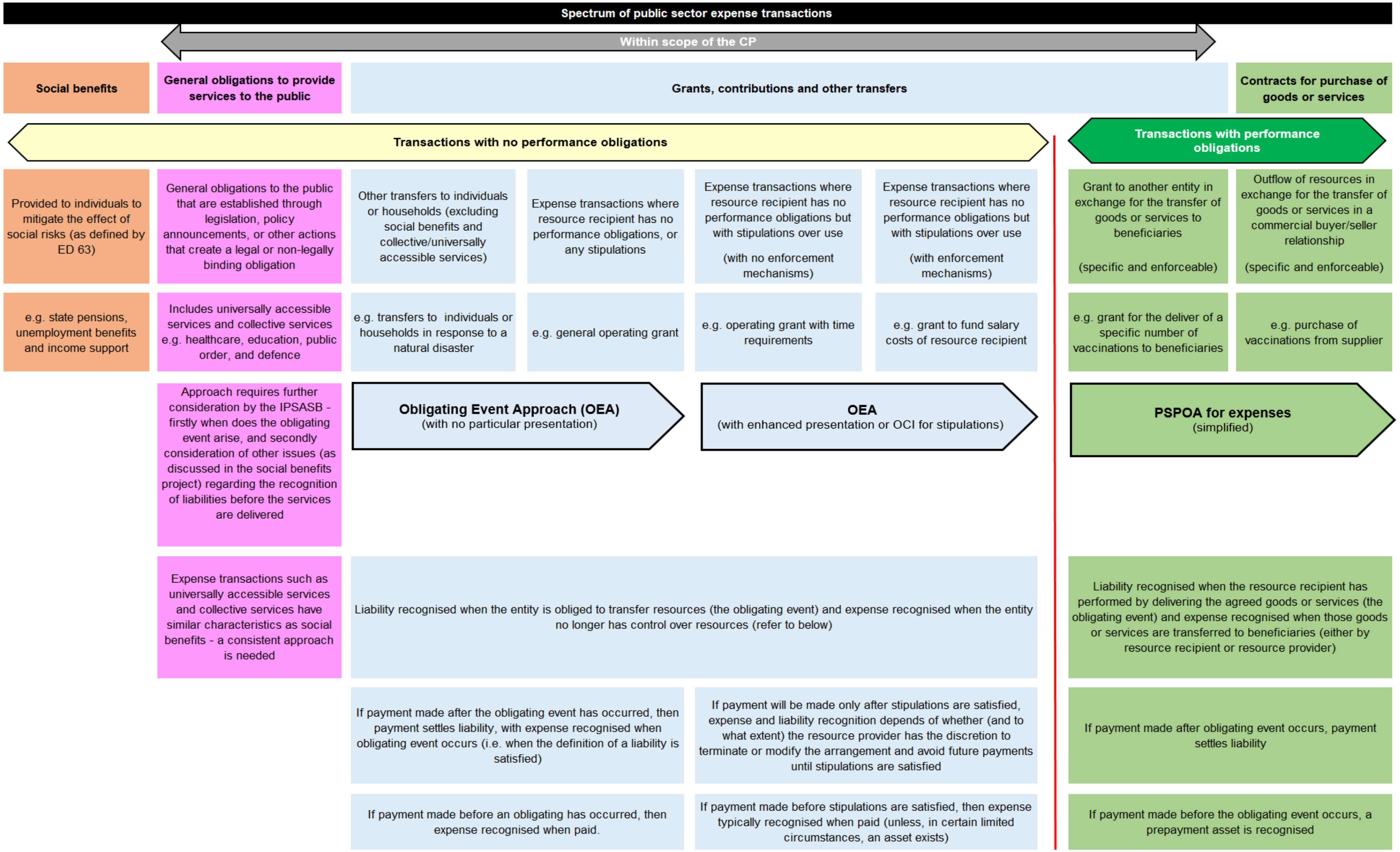
The alternative OEA proposed by the NZASB does not focus on whether the resource recipient has unfulfilled restrictions or conditions, because typically the fulfilment of these stipulations would be outside the control of the resource provider. For example, if the resource provider has already transferred the funding to the resource recipient, the existence of an unsatisfied condition does not mean that the resource provider has an asset equal to the amount of funds transferred. We therefore disagree with the IPSASB's conclusion and rationale in paragraphs 6.20 and 6.21 that the resource provider has control over the resources already transferred. The enforceable right to require the return of those resources, if and when a condition is breached, may give rise to an asset but not for the same amount as the resources transferred. For example, if the possibility of a breach is small, any asset recognised would be for a small amount only.

The NZASB considers that an OEA developed from the context of the resource provider is a better starting point for developing an approach for liability and expense recognition. The OEA would not attempt to mirror a revenue recognition approach, but instead is an approach developed from the context of the reporting entity, the resource provider.

NZASB's proposed framework for recognition of expense transactions in the public sector

Diagram 2 below provides an overview of the NZASB's proposed framework for the recognition of expense transactions in the public sector. Further details of our proposed framework are provided after diagram 2.

Diagram 2 NZASB's proposed framework for expense recognition



Further explanation of the NZASB's proposed framework for expense recognition

<u>Social benefits and general obligations to provide services to the public</u>

We note that the scope of the CP specifically excludes the accounting for social benefit expense transactions. The IPSASB currently has a separate project considering the accounting for social benefits with ED 63 *Social Benefits* currently open for comment.

The accounting for social benefit expense transactions as proposed by ED 63 has been included in diagram 2 for completeness. The NZASB has yet to commence deliberations on the proposals in ED 63. We are currently considering our response to the scope of the ED as well as the proposals in the ED.

For this comment letter, the NZASB considers that the determination of an obligating event for social benefit schemes is not substantively different from general obligations to provide services to the public, which includes collective services and universally accessible services as defined in the CP.

For these general obligations to provide services to the public, similar issues arise as are being considered in the IPSASB's project on social benefits. In many cases, the beneficiaries of these services have existing rights that have been established through legislation, policy announcements, or other government actions. For example, in New Zealand, the Government's obligations to provide universal superannuation to beneficiaries over 65 (a social benefit) and to provide free education for children aged between 5 and 19 (a universally accessible service), are both established through legislation. In our view, there is no substantive difference between benefits provided in the form of money (e.g. national superannuation) or in the form of services (e.g. education services). Accordingly, issues being discussed in the project on social benefits relating to determining the point when (and the extent to which) the government concerned has a present obligation to provide those benefits also arise in the context of universally accessible services and collective services.

Therefore, the NZASB considers that where expense transactions such as social benefits, collective services and universally accessible services have similar characteristics, a consistent approach for liability and expense recognition is required. We therefore encourage the IPSASB to consider how any decisions made in the development of standards-level requirements for social benefits would impact the development of an approach for recognising other expenses and liabilities arising from similar types of transactions, such as collective services and universally accessible services.

Furthermore, in our view, the IPSASB's conclusion in paragraph 6.38 that there is no obligation prior to the delivery of services is not based on a sound rationale, as the rationale provided appears to mix the issue of measurement of a liability with the existence of a liability – the fact that a government might be able to vary the level of services provided could impact on *the extent* of its obligation to beneficiaries, but it does not follow that *no* obligation exists.

Nevertheless, we appreciate that an alternative conclusion that a liability arises at an earlier point has potentially significant consequences. It raises issues similar to those discussed under the social benefits projects – for example:

(a) the usefulness of the financial statements if large liabilities are recognised for obligations to deliver future ongoing services to the public;

(b) public sector entities are often obligated to provide services to the public in future periods, based on the expectation that the funding will be obtained from the public substantially in future periods (an entity cannot recognise an asset for the right to collect future taxes); and

(c) accounting for executory contracts – some argue that the government's right to collect future taxes from which it will meet its obligations to provide social benefits, and other services that are part of the ongoing activities of the government, are akin to an executory contract with its citizens.

<u>Other transfers to individuals or households</u>

We note the CP focuses mainly on the accounting for universally accessible services and collective services when discussing liability and expense recognition arising from obligations to provide resources to the public.

Public sector entities have a wide range of other obligations to the public that relate to specific government programmes, such as the provision of relief to affected individuals or households in the event of a natural disaster. In certain circumstances, a present obligation could exist before the resource recipient has transferred resources to the beneficiaries concerned or engaged with a supplier or another entity to deliver the services. For example, in implementing a programme of services to the public, there are various points in time to consider when a present obligation may arise:

(a) public expectations established from past practices of the public sector entity, creating a constructive obligation;

(b) making a political promise such as an electoral promise;

(c) announcements of a policy;

(d) passing of legislation (if applicable) to implement the policy;

(e) approval of the budget or communication of budget appropriations; or

(f) when the budget becomes effective.

The early stages of implementing public policy are unlikely to give rise to present obligations that meet the definition of a liability, because there is greater ability to avoid the outflow of resources. Later stages, especially when any eligibility criteria or stipulations are met, are more likely to give rise to present obligations that meet the definition of a liability, because there is less ability to avoid the outflow of resources.

In our view, the definition of a liability in the Conceptual Framework and the guidance in IPSAS 19 can be applied in determining when a liability (and corresponding expense) arises for other obligations to provide resources to individuals or households that are not defined as social benefits, collective services or universally accessible services.

We note the CP does not fully address the accounting for these other non-exchange expense transactions that arise for other obligations to provide resources to individuals or households. We encourage the IPSASB to complete further analysis for this category of non-exchange expenses.

Grants, contributions and transfers to other entities — no performance obligations or stipulations[5]

When an obligation requires an outflow of resources from the resource provider, for which the resource recipient is not required to satisfy any performance obligations or stipulations, the liability and expense would be recognised immediately when the obligating event occurs. In these circumstances, the resource provider has little or no realistic alternative to avoid an outflow of resources, when the transfer is approved and communicated to the resource recipient.

When payment occurs either before or after the obligating event, then the Conceptual Framework's definition of a liability and asset should be considered to determine when the expense should be recognised.

Payment after an obligating event has occurred

If payment is made after an obligating event has occurred, then the liability and expense is recognised when the obligating event occurs (i.e. when the definition of a liability is satisfied). In these circumstances, the payment of the obligation would result in a reduction (i.e. settlement) of the liability already recognised.

Payment before an obligating event has occurred

If payment is made before an obligating event has occurred, then the expense is recognised at the point of payment. In these circumstances, the resource provider no longer has control of the resources transferred when paid, because there are no performance obligations or stipulations and, therefore, the resource provider does not have an enforceable right to require the resource recipient to return the resources (i.e. the prepayment does not satisfy the definition of an asset).

This outcome may arise when a grant, contribution or transfer is approved by the resource provider and paid without notifying the resource recipient before the payment is made. For example, suppose a potential grant recipient applies for a discretionary grant, which the resource provider later approves and makes payment at the same time as notifying the recipient that the grant has been approved. In these circumstances, the payment and the obligating event would occur simultaneously.

Grants, contributions and transfers to other entities — no performance obligations but with stipulations (with no enforcement mechanisms)

When an obligation requires an outflow of resources from the resource provider, for which the resource recipient is not required to satisfy any performance obligations, but there are stipulations

[5] Consumption-based stipulations arise when the resource provider agrees to transfer resources with the expectation that the resource recipient would use the resources as specified. Consumption-based stipulations do not impose on the resource recipient an obligation for the direct outflow of resources to another party, and include time-based stipulations.

over use, we propose an OEA be applied. Under this approach the liability and expense would be recognised immediately when the obligating event occurs.

A PSPOA for these non-exchange expenses, as proposed by the CP, is not considered appropriate because the resource recipient is not required to satisfy any performance obligations. This has also been discussed above.

We consider there are two potential options to enhance the presentation of expenses recognised in the surplus or deficit of the resource provider in the reporting period, which have stipulations over use that are expected to be satisfied by the resource recipient in future periods. We have explained these two options below. Later, we provide our views on which option is our preferred option.

1. Presentation and disclosure— expenses are recognised when the obligating event occurs but with enhanced presentation through the statement of financial performance and note disclosure to highlight any stipulations over use. This option is similar to the presentation option that we discuss in the context of revenue recognition.

2. Other comprehensive income — presenting revenue and expenses outside of the reported surplus or deficit, similar to the presentation of other comprehensive income (OCI) in IFRS Standards. This option is similar to the OCI option that we discussed in the context of revenue recognition. This option would be appropriate only for transactions where there are resources transferred with clear stipulations imposed by the resource provider. This is because the stipulations need to be sufficiently clear to enable the resource provider to determine when the stipulation has been met or has lapsed.

   On initial recognition, the resource provider would recognise the expense as a debit in the OCI section within the statement of financial performance and then it is taken to a separate reserve within net assets/equity. As the resources are used by the resource recipient in the manner specified, the amount initially recognised in OCI is recycled from the separate reserve to an expense in surplus or deficit.

   This option keeps the balance sheet consistent with the definitions of elements in the Conceptual Framework. An expense would still be recognised in the statement of financial performance when incurred but through a separate section called OCI or an equivalent.

   This option would work only if the IPSASB introduces OCI into the IPSAS literature. This option would require the IPSASB to develop principles for what should be recognised in OCI. This option would not work if the expenses are recognised directly in net assets/equity. If the resources are recognised directly in net assets/equity, this is less transparent and potentially misleading, as it does not clearly reflect the outflow of resources.

   The IPSASB would need to consider how far to take this OCI approach for expense transactions with different forms of stipulations, including time requirements. If this approach is advanced further, we would suggest it only be permitted when the resource provider has the ability or mechanisms in place to monitor the resource recipient's progress towards satisfying the agreed stipulations.

For these transactions with no performance obligations but there are stipulations over use and no enforcement mechanisms, we are proposing the OEA be applied, together with the either the presentation option or the OCI option, as described above, to highlight the stipulations. These two options are consistent with those we have proposed for revenue transactions with no performance obligations, but with stipulations.

Payment after the stipulations are satisfied

If the terms of the arrangement provide for payment to be made after the stipulations are satisfied, then the liability and expense recognition would depend on when (and to what extent) the resource provider no longer has the discretion to avoid the future outflow of resources. A present obligation only exists to the extent to which the resource provider has little or no realistic alternative to avoid an outflow of resources.

In some cases, the existence of unfulfilled stipulations at the reporting date may provide the resource provider with the discretion to avoid incurring the future outflow of resources. This would depend on the terms of the arrangement and whether the resource recipient has already commenced activities to fulfil those stipulations. For example, for future funding relating to activities that have not yet commenced, it is necessary to consider whether (and the extent to which) the arrangement gives the resource provider the discretion to terminate or modify the arrangement, and thereby avoid future payments. In these circumstances, a liability and expense would not be recognised because a present obligation arising from past events does not exist. Judgement is required is determine under what circumstances the resource provider can legitimately withdraw from or modify the arrangement.

For example, if an operating grant is provided with future funding instalments based on time requirements only, then the resource provider can only legitimately withdraw from future instalment payments when there is evidence that the resource recipient will not continue operating in the future. Without this evidence, it is unlikely the resource provider has the ability to avoid a future outflow of resources at the reporting date, and a liability and expense for the full amount of agreed future grant payments should be recognised immediately. Claims that are unconditionally enforceable, subject only to the passage of time, are generally considered to be present obligations in the context of the definition of a liability.

We encourage the IPSASB to develop guidance at a standards-level on the circumstances in which the future transfer of resources remains within the control of the resource provider, resulting in the resource provider having a realistic ability to avoid a future outflow of resources. This could entail drawing and building upon the existing guidance in IPSAS 19.

Payment before the stipulations are satisfied

If payment is made before the resource recipient has satisfied the stipulations, then typically the expense should be recognised when paid (if not already recognised earlier). In some cases, an asset might arise. For arrangements with no enforcement mechanisms, it is unlikely that an asset would arise, but an asset could arise in some cases where the arrangement has enforcement mechanisms (discussed in the following section).

Grants, contributions and transfers to other entities — no performance obligations but with stipulations (and enforcement mechanisms)

Similar to our discussion under revenue, the NZASB considered whether expense transactions with no performance obligations but with enforceable stipulations should apply the broad notion of performance obligations where the expense is deferred until the stipulations are satisfied or lapse. We came to the same conclusion as revenue. The resource recipient satisfying those "obligations" will spend the resources received on acquiring other resources for the recipient itself, rather than transferring goods or services to the resource provider or specified beneficiaries, so an asset does not exist for the resource provider. In other words, unlike transactions with enforceable performance obligations for the delivery of goods or services, the resource provider has no prepayment asset in these transactions.

The transfer of resources in exchange for the satisfaction of stipulations would generally not result in the resource provider retaining control of the resources transferred nor obtaining any rights to the future performance by the resource recipient for the delivery of goods or services. Therefore, when a liability is recognised for the obligation to transfer resources, a corresponding asset cannot be recognised by the resource provider for unperformed stipulations.

We acknowledge that, for this category of transactions, the Conceptual Framework's discussion of "other resources" [6] could be applicable. Even though the Conceptual Framework's definition of an asset is not satisfied in these circumstances, deferral of expenditure for unperformed stipulations (which are enforceable) could be considered under the "other resources" approach.

In our discussions with constituents, some have highlighted the challenges from a financial performance perspective, when grant arrangements are expensed upfront. However, for some resource providers the corresponding revenue to fund the settlement of these grant obligations is recognised in future periods. However, on balance, we concluded that it is not appropriate to defer expense recognition and report either an asset or "other resource" in the statement of financial position when the resource provider does not control any resources already transferred to the resource recipient and cannot avoid the future outflow of resources (in the case of liabilities for future transfers of resources to which the resource provider is already obligated), as that does not faithfully represent the resource provider's financial position.

For this reason, we recommend the IPSASB explores the presentation and OCI options (discussed above). In our view, these options could help to resolve the problem of explaining the resource provider's performance story, while also faithfully representing the resource provider's financial position.

Payment after the stipulations are satisfied

The accounting treatment for payment after the stipulations are satisfied is consistent with other transactions with stipulations (discussed above).

[6] IPSASB's Conceptual Framework, paragraph 5.4

Payment before the stipulations are satisfied

If payment is made before the resource recipient has satisfied the stipulations, then typically the expense should be recognised when paid (if not already recognised earlier). In some cases, an asset might arise. For example, it could be appropriate to recognise an asset in the following circumstances:

(a) clear repayment provisions for non-compliance with any stipulations have been agreed with the resource recipient;

(b) there is a history of the resource provider seeking refunds for non-compliance with any stipulations; and

(c) it is considered probable that there will be an inflow of resources from the resource recipient resulting from non-compliance with any stipulations.

The above would include consideration of whether the resource recipient has the resources available to return the funds, in the event of failing to meet an agreed stipulation (and the time value of money, if significant).

Grants are often paid before the obligating event to provide other public sector and NFP entities with the funding required to continue operations. We therefore expect it would be unusual for the resource provider to expect stipulations will not be satisfied when an arrangement is initially entered into. However, in subsequent reporting periods, evidence may become available that the stipulations will not be satisfied. At this time, the resource provider will reconsider if an asset for the return of resources should be recognised.

Resource providers that provide a large number of grants to multiple recipients could have a history whereby not all resource recipients will satisfy the stipulations and some will return the resources. The IPSASB would need to consider the appropriate unit of account for the recognition and measurement of assets relating to the return of resources. This could be measured on an individual basis or as a class. The recognition and measurement of such assets would be different depending on the unit of account.

If an asset does arise, the IPSASB would need to consider how to account for the return of funds in the statement of financial performance. For example, there is a question about whether this amount would be netted off against any current grant expenditure or recognised separately as some form of revenue.

<u>Our preference on whether to use the presentation option or the OCI option</u>

Overall, the NZASB has similar views on which approach to apply as discussed earlier in the context of revenue recognition, in that the majority of NZASB members prefer the presentation option, with a minority preferring the OCI option. However, some NZASB members that preferred the presentation option also expressed some support for exploring the OCI option if there are significant difficulties in developing the presentation option.

Nevertheless, some NZASB members consider that there are different considerations in the context of expense recognition compared with revenue recognition and, therefore, do not necessarily consider that the same OCI option should apply to the resource provider. An OCI option from a resource provider perspective would be inherently difficult to apply, because the resource provider would often have little control over the satisfaction of agreed stipulations by the resource recipient and may not have sufficient information to determine when those stipulations have been satisfied (especially in the case of unenforceable stipulations). However, if the IPSASB chooses to develop the OCI option for revenue, some NZASB members and some New Zealand constituents suggested that an OCI option for non-exchange expenses should also be considered.

<u>Grants, contributions and transfers to other entities — transfer of goods or services to beneficiaries (specific and enforceable)</u>

The NZASB is of the view that where an arrangement entails specific and enforceable performance obligations for the resource recipient to transfer goods or services either directly to beneficiaries or to the resource provider, the resource provider should account for the outflow of resources by using the PSPOA for expenses (simplified).

Under this approach, the obligating event arises for the resource provider when agreed performance obligations are satisfied by the resource recipient.

Consistent with our proposed approach for revenue, the PSPOA for expenses should apply only to transactions with performance obligations, and therefore we do not agree with PV 7 that the PSPOA for expenses should also apply to non-exchange expense transactions with stipulations.

Payment before the performance obligations are satisfied

If payment is made before the resource recipient has satisfied the performance obligations, then a prepayment asset is recognised. When there are specific and enforceable performance obligations, the resource provider has an enforceable right to the performance by the resource recipient for the future delivery of goods or services, and it is assumed that remedies are available for the return of funds when agreed goods or services are not delivered.

Payment after the performance obligations are satisfied

If payment is made after the resource recipient has satisfied the agreed performance obligations, then the payment settles the resource provider’s liability to the resource recipient, as a liability and expense is recognised earlier, at the point when the agreed goods or services have been transferred to the agreed beneficiaries.

APPENDIX 2 Response to Preliminary Views and Specific Matters for Comment

Preliminary View 1 (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 reason.

We broadly agree with PV 1, subject to our earlier comments on our proposed framework and our comments below.

As discussed earlier, under our proposed framework, the existence or absence of performance obligations in revenue transactions should be the key determinant for revenue recognition in the public sector.

Therefore, in our view, all revenue transactions with performance obligations should be accounted for under an IPSAS based on IFRS 15, the PSPOA. Hence, we consider that the PSPOA should be applied more broadly than Category C transactions. As noted in our discussion of our proposed framework, there is scope for certain transactions in Category B to be accounted under the PSPOA. This includes performance obligation transactions that are enforceable through other means and involves the transfer of goods or services to beneficiaries, including those which are subsidised or on a cost-recovery basis.

However, the scope of the PSPOA would depend on how the IPSASB defines key factors such as enforceability and performance obligations.

An IPSAS based on IFRS 15 would assist our PBE groups that include for-profit controlled entities by reducing unnecessary consolidation adjustments for Category C revenue transactions.

It would also assist public sector entities with debt securities on international stock exchanges. The international stock exchanges require identifying the differences between our PBE Standards[7] and the IFRS Standards. An IPSAS based on IFRS 15 would assist the readers of these entities' financial statements to see no major differences between PBE Standards and IFRS Standards.

An IFRS 15 convergence project for Category C revenue transactions may appear simple at face value. However, this process will likely include a number of challenges as recently experienced by the Australian Accounting Standards Board (AASB), which completed a similar project at the end of 2016. Some of the challenges the AASB had to address are noted below. Some of these challenges

[7] PBE Standards are based on IPSASs

are already covered in the *Broadened for the Public Sector* sections of the CP chapter 4, but we wanted to re-emphasise their importance for when the IPSASB develops an IPSAS based on IFRS 15.

- Enforceability – what is enforceability in the public sector? The AASB noted a return obligation is an indicator of enforceability, but not the only indicator. The AASB expanded the enforceability guidance to include a range of factors that could potentially result in an enforceable arrangement. Some examples of these factors are the resource provider's right to enforce specific performance or claim damages or agreement on the alternative uses for the resources provided. The IPSASB would need to consider the appropriate enforcement mechanisms in the public sector which results in the resource recipient having a present obligation for unfulfilled performance obligations.

- Performance obligations – what is a performance obligation in the public sector? AASB 2016-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities* notes some resources are provided with no, or minimal, terms and conditions on how the resources must be used. Other resources may have stipulations only in the form of time requirements. For these reasons, it can be difficult to distinguish goods or services provided to meet a general requirement from any of the not-for-profits' other goods or services provided.[8] The AASB kept the principle that a performance obligation exists only if it is sufficiently specific to enable the recipient to determine when it has satisfied that obligation.[9] In addition, as discussed earlier, the type of "performance obligations" within the scope of the PSPOA should be limited to those that require the transfer of goods or services to other parties, rather than the broader notion of "performance obligation" currently in IPSAS 23.

  The IPSASB would need to develop an appropriate definition of a performance obligation with supporting guidance. The definition should be consistent with the definition of a performance obligation in IFRS 15, but adapted for the public sector.

- Transactions with two components – how and when to account for transactions where there is a performance obligation and another component? For example, in a fundraising dinner, the ticket price could exceed the usual market rate for the dinner, indicating that there are two components: the dinner (for which there is a performance obligation) and a donation. One of the issues the AASB had to consider was the subjectivity in assessing the resource provider's intent when they make the donation and often this intent is not known due to a lack of evidence.[10] The AASB ended up developing guidance on determining the circumstances in which the donation component should be separated from the performance obligation component.

- Licences – the AASB is currently considering the accounting treatment of public sector licences. Issues it is considering include determining the circumstances in which the revenue from granting a licence is, in substance, a tax (and hence should be accounted for in the same way as taxes) or involves the delivery of goods or services (and hence should be accounted for

[8] AASB 2016-8.BC38

[9] AASB 2016-8.BC49

[10] AASB 2016–8.BC52

under the PSPOA). For some public sector entities, accounting for licence revenue is a significant issue, so the IPSASB would need to consider how this would be addressed.

- Direct relationships between inputs and outputs – in the public sector, there are transactions where the arrangement does not explicitly require the transfer of a good or service but may do so implicitly where there is a direct relationship between the funding and the outputs delivered. Such arrangements have all the criteria to fall within the scope of IFRS 15 except the explicit requirement to transfer goods or services. We think these transactions could be accounted for under the PSPOA because, in substance, they are substantially similar to an IFRS 15 transaction – the resource provider is effectively funding the delivery of the outputs (goods or services) to other parties. For example, the resource recipient receives funding for the salary for one of its employees who is engaged in providing services to beneficiaries (e.g. a doctor providing health services) and the resource provider directs the output of that employee for the benefit of the resource provider. In this situation, there is a direct relationship between the funding and the output (services delivered by the employee to beneficiaries).

- Output-based appropriations – in New Zealand, certain public sector entities receive funding via output-based appropriations where the resource provider specifies what outputs the recipient must deliver with the funding. This can be viewed as either (a) funding the recipient or (b) buying outputs from the recipient. The recipient is accountable to the resource provider for the delivery of the agreed outputs and the arrangement is monitored by the resource provider. We recommend the IPSASB carries out research on the specificity of funding arrangements within the public sector of different jurisdictions and consider which of these transactions could appropriately be accounted for using the PSPOA.

Preliminary View 2 (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.

As discussed earlier, our proposed framework for revenue transactions in the public sector would distinguish between revenue transactions with performance obligations and those without performance obligations.

Therefore, we agree revenue transactions in Category A should be accounted for under a residual revenue standard or a residual section of a revenue standard, based on the applicable parts of IPSAS 23. IPSAS 23 would, of course, need to be updated to address practice issues relating to Category A transactions, as discussed further below in our response to SMC 1.

However, it is important to note that under our proposed framework, some parts of IPSAS 23 will be no longer applicable, such as those parts dealing with:

- the distinction between exchange and non-exchange transactions; and

- the distinction between conditions and restrictions.

Also, a future revenue standard (or section of a standard) for Category A transactions, and those transactions in Category B that do not contain performance obligations and hence are not accounted for under the PSPOA, would need to have a clearly worded scope section to make it clear that it applies only to these types of revenue transactions. For example, the standard should not apply to other transactions, such as public sector combinations.

> **Specific Matter for Comment 1 (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 have identified the following matters for the IPSASB to consider in developing a residual revenue standard (or residual section of a revenue standard) based on updating the applicable content from IPSAS 23.

- Consider modifying the taxable event to a taxable period where the tax is intended to cover a period rather than a point in time. For example, property rates are set before the beginning of the year (this is the taxable event under IPSAS 23) but the rates relate to services provided to ratepayers throughout the year rather than the point at which the rates are levied.

- Appropriations (i.e. the authorities provided by parliament for governments to spend) are integral to the operation of governments. There is often debate about how appropriations affect the accounting for revenue by entities subject to appropriations. In our view, a residual revenue standard (or section of a revenue standard) needs to discuss appropriations (including the different types of appropriation – e.g. multi-year appropriations) and provide guidance about how they affect the accounting for revenue.

- As noted in our comments on PV 1, the IPSASB would need to consider developing guidance for the recognition of revenue from granting licences. Is it a delivery of goods or services or is it a tax?

- Also, there are other types of specific rates or taxes that are related to particular goods or services, such as water rates. The IPSASB should consider developing guidance to help determine which revenue standard (or section of the standard, if there is only one revenue standard) applies to these transactions.

- In the proposed *Strategy and Work Plan 2019–2023* consultation, one of the IPSASB's proposed projects is to review IPSASs against the chapters on elements and recognition from the Conceptual Framework. As part of this review, the IPSASB should consider modifying or removing paragraphs 37–38 of IPSAS 23 which provide guidance on contributions from owners. IPSAS 23 was developed before the Conceptual Framework and this guidance may no longer be needed now that the IPSASB has the Conceptual Framework.

Preliminary View 3 (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.

The NZASB does not agree that all Category B transactions should be accounted for using the PSPOA.

As noted in our earlier comments on our proposed framework, there is a wide spectrum of transactions in Category B. The scope of Category B transactions that could be accounted for using the PSPOA would depend on how the IPSASB defines key factors such as enforceability and performance obligations.

Under our proposed framework, all revenue transactions with performance obligations should be accounted for under the PSPOA. The PSPOA would be appropriate for revenue transactions that involve the transfer of goods or services to either the resource provider or resource beneficiaries. The PSPOA would not be appropriate for consumption-based stipulations (even if they are accompanied by return conditions and/or other enforcement mechanisms) because these are not performance obligations that result in an outflow of resources. We have discussed in Appendix 1 the approaches under our proposed framework for the other Category B transactions (with no performance obligations but with consumption-based stipulations).

We have identified transactions which are currently in IPSAS 23 that we consider should be accounted for using the PSPOA. As discussed earlier, these are transactions that are enforceable through other means and involve the transfer of goods or services to beneficiaries, including those which are subsidised or on a cost-recovery basis. See our earlier discussion of our proposed framework for the full details.

We have also identified a range of issues to be considered in developing the PSPOA, as discussed in PV 1 and SMC 2.

Specific Matter for Comment 2 (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 agree with broadening the requirements of the IFRS 15 model in developing the PSPOA. We have commented on steps 1 and 2.

Step 1 – Identify the binding arrangement

- We agree with the broader concept of enforceability. In discussions with constituents, some have advocated a further broadening, but we do not agree that it would be appropriate, for example, to extend this to moral obligations. A PSPOA is appropriate only when the resource provider has enforcement mechanisms available, as discussed earlier (see our response to PV 1).
- The IFRS 15 revenue recognition approach should be extended under the PSPOA to capture revenue transactions with three party arrangements (resource provider, resource recipient and resource beneficiary). The key requirement is for the resource recipient to have an obligation to transfer goods or services to an external party, which could be the resource provider or the third-party resource beneficiary. This approach is consistent with IFRS 15, as the customer may not always receive the goods or services in transactions that fall within the scope of IFRS 15 (e.g. where a customer contracts with a florist to deliver flowers to a third party).
- One of the criteria for a contract to fall within the scope of IFRS 15 is commercial substance (i.e. the risk, timing or amount of the entity's future cash flows is expected to change as a result of the contract). AASB 2016-8 notes contracts that include a subsidy or which are provided on a cost-recovery basis can be accounted for under IFRS 15. Although these arrangements provide goods or services without generating a commercial return, they may still cause a change in the risk, timing or amount of the NFP entity's future cash flows.[11]

[11] AASB 2016-8.F19

Therefore, we consider transactions that transfer goods or services to beneficiaries with a subsidy or cost-recovery basis should be accounted for under the PSPOA.

Step 2 – Identify the performance obligations

- The IPSASB would need to develop an appropriate definition of a performance obligation with supporting guidance. The definition should be consistent with a performance obligation as defined in IFRS 15 but adapted for the public sector.

- In the public sector, identifying specific performance obligations and unbundling performance obligations will require a greater level of judgement than in the for-profit sector because there is often less detail on the specification of the goods or services to be delivered. We therefore encourage the IPSASB to develop guidance on defining specific performance obligations in a public sector context.

- To assist preparers in identifying specific performance obligations within binding arrangements in the public sector, we suggest the following factors[12] be considered:

  (a) the nature or type of the goods or services;

  (b) the cost of value of the goods or services;

  (c) the quantity of the goods or services; and

  (d) the period over which the goods or services must be transferred.

  In general, for a performance obligation to be considered specific enough for the PSPOA to be applied, these factors would need to be identified as agreed terms which are enforceable.

- We agree with the IPSASB's view in the CP that a time requirement in and of itself does not create a performance obligation. For revenue transactions where the time period for using the resources is specified, but the exact nature of the goods or services to be transferred is not specified, these transactions should be accounted for under a residual revenue standard (or residual section of a revenue standard). For the PSPOA to apply, a time requirement is not a factor of performance obligations; rather, one of the key factors is that there should be a link between the resources received and the transfer of goods or services externally.

- Also, see our earlier responses for other issues to consider (such as our response to PV 1).

[12] AASB 2016-8.F20

Specific Matter for Comment 3 (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.

As noted earlier, our preference is for the IPSASB to develop an approach based on whether or not there are performance obligations arising from Category B transactions, rather than developing requirements based on the current exchange or non-exchange classification. We accept that for revenue transactions with no performance obligations, but there are stipulations over use (relating to either when or how the funds must be used), a residual revenue standard (or residual section of a revenue standard) is required (together with Category A transactions).

The NZASB does not support Approach 1 as it:

- does not resolve the current issues experienced with the exchange or non-exchange distinction in IPSASs;
- does not promote the accounting for a broader range of public sector transactions under an IFRS 15 revenue recognition approach; and
- addresses concerns regarding the accounting for transactions with time requirements only. It does not address the accounting for other public sector transactions which may not have performance obligations as defined under IFRS 15 but have other stipulations as to how the funds must be used.

Whilst we do not support Approach 1, we support the IPSASB in considering option (b) and an extension of option (e) for transactions with no performance obligations but which have stipulations over use. We explain these two options below.

Presentation

Under our proposed framework, this option is the same as Approach 1 "The Exchange/Non-Exchange – Update IPSAS 23", option (b) proposed in the CP. Revenue is recognised when resources are received or receivable but with enhanced presentation to highlight the stipulations over use. This option stays true to the definitions of elements in the Conceptual Framework and gives the resource recipient a method of communicating its performance story to the users of financial statements. This option would help to educate users to focus not only on the surplus or deficit (the "bottom line") but to look at what makes-up the surplus or deficit.

A university in New Zealand, the University of Auckland (Auckland University), has used this presentation option (under the current PBE Standards) to separate its unrestricted and restricted funds in the statement of financial performance, statement of financial position and statement of changes in net assets. These statements are supported by accounting policies and note disclosures. Auckland University wanted to clearly identify its core operating activities and thought this presentation was the best way to achieve this. This example may be of interest to the IPSASB in developing this option.[13]

Financial Accounting Standards Board (FASB) Statement No. 117, *Financial Statements of Not-for-Profit Organisations* (Statement No. 117) provides specific guidance for the presentation of restricted funding received by NFPs within general purpose financial statements. Statement No. 117 requires classification of an organisation's net assets and its revenues, expenses, gains, and losses based on the existence or absence of donor-imposed restrictions. It requires that the amounts for each of three classes of net assets—permanently restricted, temporarily restricted, and unrestricted—be displayed in a statement of financial position and that the amounts of change in each of those classes of net assets be displayed in a statement of activities.[14] Statement No. 117 provides guidance using the columnar presentation.

In 2016 the FASB issued Accounting Standards Update 2016–14 *Presentation of Financial Statements of Not-for-Profit Entities* (ASU)[15]. The main changes in ASU are:

- the three classes of net assets in the statement of financial position and the change in each of those classes of net assets in the statement of activities are replaced with two classes, net assets with donor restrictions and net assets without donor restrictions;
- enhanced disclosures about the composition of net assets with donor restrictions at the end of the period and how those restrictions affect the use of resources; and
- requiring an analysis of how the nature of the NFP's expenses relates to its programmes and supporting activities.

The FASB's guidance may be of interest to the IPSASB in developing this option.

In developing this option, we recommend the IPSASB does not mandate this requirement as it would create extra compliance costs for preparers, particularly for those entities that are not significantly impacted by stipulations over use. However, the IPSASB should encourage this option in the statement of financial performance in the period the resources are received so users can understand the resource recipient's results and the impact of the stipulations on the resources received. To

13 University of Auckland 2016 Annual Report https://cdn.auckland.ac.nz/assets/auckland/about-us/the-university/official-publications/annual-report/2016-annual-report-university-of-auckland.pdf

14 Equivalent to a statement of financial performance

15 https://asc.fasb.org/imageRoot/56/92564756.pdf

assist preparers in applying this option, we recommend that the IPSASB develops illustrative examples so that preparers can see what these presentations could look like.

Other comprehensive income

Under our proposed framework this option is an extension of Approach 1, option (e) proposed in the CP. Our option would require the IPSASB to develop principles for presenting revenue and expenses outside of surplus or deficit, similar to the presentation of OCI in IFRS Standards (for the reasons explained below). This option would be appropriate only for transactions where there are resources with clear stipulations imposed by the resource provider. On initial recognition, the recipient would recognise the inflow of resources in the OCI section within the statement of financial performance and then take those resources to a separate reserve within net assets/equity. As the resources are used (either over the specified time, in the case of time-based stipulations, or in the manner specified, in the case of consumption-based stipulations), the amount initially reported in OCI is recycled to revenue. Our suite of PBE Standards already has the concept of OCI, which we refer to as "other comprehensive revenue and expense". Before introducing our suite of PBE Standards based on IPSAS, our public sector entities had previously applied New Zealand equivalents to IFRS Standards, including OCI, so we carried forward OCI into our suite of PBE Standards.

This option keeps the balance sheet consistent with the definitions of elements in the Conceptual Framework. The resources would still be recognised in the statement of financial performance when received or receivable, but through a separate section called OCI or an equivalent.

This option overcomes the strict principle in IPSAS 23, which does not permit revenue from the receipt of resources with no conditions to be recognised at the time when the stipulations are met or lapse. This approach acknowledges the stipulations placed on the resources as this is shown clearly in the statement of financial performance and is more likely to result in revenue being included in surplus or deficit in the same periods in which the resources are used.

This option would work only if the IPSASB introduces OCI into the IPSAS literature. This option would require the IPSASB to develop principles for what should be recognised in OCI. This option would not work if the resources are recognised directly in net assets/equity. If the resources are recognised directly in net assets/equity, this is less transparent and potentially misleading, as it is presenting a message that the recipient has not benefited from receiving the resources, which does not reflect the substance of the transaction.

In developing this option, we recommend the IPSASB considers mandating this requirement as it would allow consistency within the financial statements of resource recipients and promote comparability between reporting entities.

The majority of NZASB members prefer the presentation option, with a minority preferring the OCI option. In addition, some NZASB members that prefer the presentation option would also accept the OCI option if there are significant difficulties in developing the presentation option.

Option (c) and option (d)

For completeness, we would like to note that we do not support option (c) because a time requirement does not meet the definition of a liability.

We also do not support option (d) because we do not support the introduction of the notion of "other obligations", which are not liabilities. We also note that time requirements are not an economic phenomena that should be treated any differently from other revenue transactions with no performance obligations but which have stipulations over use. See Appendix 1 for additional discussion on these points.

Specific Matter for Comment 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.

As noted earlier, we do not support the IPSASB retaining the exchange or non-exchange distinction. The CP notes that preparers have indicated the difficulty and time consumed in making this distinction. Many of our preparers and auditors have also experienced this difficulty and have spent a considerable amount of time in making this distinction but there is no apparent value to the users of the financial statements.

However, if the IPSASB retains the exchange or non-exchange distinction, then we agree additional guidance on this distinction should be used in combination with our preferred options in SMC 3. A lot of additional guidance on this would be helpful given the issues in application. We agree that additional guidance would be required on the meaning of the phrases "directly giving" and "approximately equal value" which are currently used in the definition of non-exchange transactions.

Preliminary View 4 (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.

Under our proposed framework, capital grants would be under the category of transactions with no performance obligations but with stipulations over use, either with or without enforcement mechanisms. As discussed earlier, there are different views on the appropriate accounting for these transactions.

We agree the IPSASB should address the accounting for capital grants in an IPSAS. This is an important matter for our constituents so we encourage the IPSASB to develop appropriate solutions by considering the approaches we have discussed below in our response to SMC 5.

Specific Matter for Comment 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.

(b) Consistent with our discussions for transactions with no performance obligations but with stipulations over use, we recommend the IPSASB considers the presentation and OCI approaches for the accounting of capital grants.

Presentation approach

This approach is the same as Approach 1 "The Exchange/Non-Exchange – Update IPSAS 23", option (b) proposed in the CP. Revenue is recognised when received or receivable and using presentation to highlight the stipulation. This option stays true to the definitions of elements in the Conceptual Framework and gives the resource recipient a method of communicating its performance story to the users of financial statements.

Other comprehensive income approach

The OCI approach is the same as the OCI option in our discussion in Appendix 1. On initial recognition, the recipient would recognise the inflow of resources in OCI within the statement of financial performance and then take those resources to a separate reserve within net assets/equity. As the resources are used to construct the asset over the specified time or when the asset is acquired, OCI is recycled to revenue. We consider that the stipulations on resources provided for the acquisition or construction of assets are largely fulfilled when the resources are spent in the manner specified by the resource provider. We consider that the on-going requirement to use the asset for the specified purpose to be in the nature of a restriction on assets, which should be disclosed in the notes to the financial statements.

This approach would work only if the IPSASB introduces OCI into the IPSAS literature. This approach would require the IPSASB to develop principles for what should be recognised in OCI and when OCI is subsequently recycled to surplus or deficit. This approach would not work if the resources are recognised directly in net assets/equity. If the resources are recognised directly in net assets/equity, this is less transparent and potentially misleading, as it is presenting a message that the recipient has not benefited from receiving the resources, which does not reflect the substance of the transaction.

Specific Matter for Comment 6 (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.

The NZASB supports retaining the existing requirements for services in-kind, which permit, but do not require recognition of services in-kind. Leaving this as optional allows entities the choice as to whether they recognise services in-kind; entities would do so if the benefits outweigh the cost.

If the IPSASB mandates the recognition of services in-kind, entities would have to develop systems and processes to gather auditable information (which may be a challenge to audit). Preparers could end up treating this as an accounting compliance exercise. In New Zealand, compliance costs associated with the recognition of services in-kind would be an issue for many public sector entities, and particularly registered charities (which are generally subject to the same requirements as public sector entities).

Whilst we support retaining the existing guidance, we suggest the IPSASB reviews the disclosure of services-in kind. Currently in IPSAS 23.108, entities are encouraged to disclose the nature and type of major classes of services in-kind received, including those not recognised. The IPSASB could consider mandating this disclosure. This is one way to improve the financial reporting in this area.

Preliminary View 5 (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.

As discussed earlier, under our proposed framework for expense recognition, we do not agree that non-exchange transactions related to universally accessible services and collective services should be accounted for under an EOEA.

In particular, we do not agree with the "extended" part of the obligating event approach, as we disagree with the conclusion and rationale in paragraphs 6.20 and 6.21 that the resource provider has control over the resources already transferred. The enforceable right to require the return of those resources, if and when a condition is breached, may give rise to an asset but not for the same amount as the resources transferred. For example, if the possibility of a breach is small, any asset recognised would be for a small amount only.

In general, for non-exchange expense transactions with no performance obligations, we have proposed an obligating event approach, based on the Conceptual Framework's definition of a liability, and further guidance in IPSAS 19 where applicable.

However, for universally accessible services and collective services, we consider that similar issues arise as are being considered in the current IPSASB project on social benefits. For this comment letter, the NZASB considers that the determination of an obligating event for social benefit schemes is not substantively different from general obligations to provide services to the public, this being collective services and universally accessible services.

The NZASB considers that where expense transactions such as social benefits, collective services, and universally accessible services have similar characteristics, a consistent approach for liability and expense recognition is required. We therefore encourage the IPSASB to consider how any decisions made in the development of standards-level requirements for social benefits would impact the development of an approach for collective services and universally accessible services.

Further discussion on the NZASB's proposed approach is provided in Appendix 1.

Preliminary View 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.

The NZASB does not agree with the rationale provided for the PV and considers that this issue requires considerable further discussion and analysis before a robust conclusion can be reached.

In our view, the IPSASB's conclusion in paragraph 6.38 that there is no obligation prior to the delivery of services is not based on a sound rationale, as the rationale provided appears to mix the issue of measurement of a liability with the existence of a liability – the fact that a government might be able to vary the level of services provided could impact on *the extent* of its obligation to beneficiaries, but it does not follow that *no* obligation exists.

In many cases, the beneficiaries of these services have existing rights that have been established through legislation, policy announcements, or other government actions. For example, in New Zealand, children have a right to free education between age 5 and 19 (a universally accessible service) under existing legislation. In accordance with the guidance in the Conceptual Framework, the existence of liabilities is based on existing legislation.[16] Hence, it could be argued that a liability already exists to provide education to existing citizens under the age of 19.

Nevertheless, we appreciate a conclusion that a liability arises at an earlier point than when the services are delivered has potentially significant consequences. It raises issues similar to those

[16] Paragraph 5.22 of the IPSASB's *Conceptual Framework*

discussed under the IPSASB's social benefits project. We do not consider that there is a substantive difference between the types of expenses being discussed in the social benefits project and universally accessible services and collective services. We therefore encourage the IPSASB to consider how any decisions made in the development of standards-level requirements for social benefits would impact the development of an approach for universally accessible services and collective services.

Further discussion on this matter is provided in Appendix 1.

Other comments

The public sector has a wide range of general obligations to provide services to the public, which include universally accessible services and collective services as defined by the CP. When developing standards-level requirements, it will be important to clarify that any guidance on the accounting for non-exchange expense transactions arising from universally accessible services and collective services is in the context of determining when obligations to provide those services to beneficiaries arise before the resource provider engages with another organisation, employee or supplier to deliver the services to the public.

The CP notes that the delivery of universally accessible services and collective services may involve a number of exchange transactions. We expect that expense transactions arising from universally accessible services and collective services, when the resource provider engages with a supplier to deliver the services to the public, would have performance obligations and should therefore be accounted for by applying the PSPOA. Therefore, it will be important to make it clear when different expense recognition approaches would apply to the various stages of implementing a programme of delivering services to the public.

Preliminary View 7 (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.

The NZASB does not agree that a PSPOA should be applied to all non-exchange expense transactions that contain either performance obligations or stipulations.

Consistent with our proposed framework for revenue recognition, we consider that a PSPOA is only appropriate for expense transactions with performance obligations – that is, transactions where the resource recipient has an enforceable and specific obligation to transfer goods or services to the resource provider or agreed beneficiaries.

Under the proposed PSPOA for expenses, we consider that a simplified approach could be developed, based on recognising a liability and expense when performance obligations are satisfied by the resource recipient, rather than developing a full PSPOA based on the IFRS 15 five-step recognition model modified to reflect the resource provider context.

The simplified PSPOA for expenses would require the following to be considered.

(a) Definition of a performance obligation such as specificity of the goods or services to be delivered.

(b) Definition of enforceable, what enforcement mechanisms in addition to a return obligation would allow for a PSPOA to be applied?

(c) Accounting for payments before the delivery of goods or services – similar to payments made in advance to suppliers in an exchange transaction, a prepayment asset would arise.

Where the PSPOA for expenses is applied to transactions involving the resource recipient transferring specific goods and services to beneficiaries, we consider this approach would only be appropriate where the resource recipient provides reliable reporting on progression of service performance delivery to the resource provider.

The NZASB considered whether expense transactions with no performance obligations but with stipulations should apply a broader notion of performance obligations where the expense is deferred until the stipulations are fulfilled or lapse. We also considered whether to apply the Conceptual Framework's discussion of "other resources". Even though the asset definition is not satisifed, deferral could be justified under the "other resources" approach. However, as explained in Appendix 1, we do not support either of these approaches, because they would not faithfully represent the resource provider's financial position.

Instead, we recommend the IPSASB explores the presentation and OCI options as proposed under our framework. In our view, these options could help to resolve the problem of explaining the resource provider's performance story, while also faithfully representing the resource provider's financial position.

Further discussion on the NZASB's proposed approach is provided in Appendix 1.

Preliminary View 8 (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.

Our general comment on this chapter is that the discussion in the chapter is narrower than we expected. The chapter states that its purpose is to discuss the measurement of non-contractual receivables and non-contractual payables. However, the chapter focuses on statutory receivables and statutory payables only. We have assumed that the focus on statutory receivables and payables was intentional.

Paragraph 4.31 of the CP notes that many public sector arrangements are non-contractual and many binding arrangements are established through means other than legal contracts. Paragraph 7.5 of the CP notes that donations and bequests are other examples of non-contractual receivables.

Therefore, only a small portion of public sector receivables and payables are contractual. The scope of chapter 7 of the CP is wider than what the actual chapter has covered.

Given the wide scope of non-contractual receivables and non-contractual payables, we recommend that the IPSASB first establish the recognition approaches for revenue and non-exchange expenses. The recognition approaches will then drive the appropriate measurement. The South African Accounting Standards Board's (ASB) GRAP 108 *Statutory Receivables* may assist the IPSASB with the measurement of statutory receivables. We have provided further details of GRAP 108 below.

Therefore, we do not agree with the preliminary view that all non-contractual receivables should be measured at face value on initial recognition.

GRAP 108 has guidance on the initial and subsequent measurement of statutory receivables. GRAP 108 requires statutory receivables to be initially measured in accordance with the relevant standard of GRAP. We suggest the IPSASB looks at GRAP 108 for guidance in developing the initial measurement of non-contractual receivables.

Examples of where initial measurement would be different under our proposed framework are as follows.

- Transactions with performance obligations would be accounted for using the PSPOA. The initial measurement of receivables should be an IPSAS based on IFRS 15. Subsequently, any impairment on receivables are recognised in accordance with an IPSAS based on IFRS 9 *Financial Instruments*.
- Statutory receivables generally do not have performance obligations or stipulations. For these types of transactions (which would be in a residual revenue standard (or residual section of a revenue standard) based on an updated version of the applicable parts of IPSAS 23), it would be appropriate to initially measure the receivable at face value. Face value has information value and is easier for users to understand. The face value should be supported with disclosure of the impairment. Face value measurement and the disclosure of impairment promote accountability and transparency.

Preliminary View 9 (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.

The NZASB agrees with PV 9 for statutory receivables. However, as noted in our response to PV 8, the CP focuses only on statutory receivables. The scope of chapter 7 of the CP is *non-contractual receivables*, this covers all receivables that are non-contractual. Subsequent measurement of non-contractual receivables will depend on the type of revenue.

Given the wide variety of non-contractual receivables, we recommend that the IPSASB first establish the recognition approaches for revenue. This will then help to drive the appropriate measurement.

For statutory receivables, the fair value approach has appeal because it appears the most workable of the three approaches to apply in practice. However, we would strongly support the IPSASB in determining the presentation and disclosure for statutory receivables starting from scratch, and not automatically adopting all the disclosures from IFRS 7 *Financial Instruments: Disclosures* by analogy. Many of the IFRS 7 disclosures have been designed with commercial contractual arrangements in mind, with a focus on counter-party credit risk. Many of the disclosures therefore would not be applicable to statutory receivables.

In the New Zealand context, the Government's tax receivable portfolio is not overly sensitive to discount rates, but that may not be the case in other jurisdictions. The IPSASB would need to consider how the volatility in a discounted cash flow is best presented in the statement of financial performance. Also, the IPSASB would need to consider where the fair value gain or loss is displayed in the statement of financial performance and what it is called. It may be better to display the movement in the same line each year, regardless of whether it moved from a loss or gain in different years.

Specific Matter for Comment 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.

As noted in our response to PV 7 and PV 8, given the wide range of non-contractual receivables and non-contractual payables, we recommend that the IPSASB first establish the recognition approaches for revenue and non-exchange expenses. This will then drive the appropriate measurement.

Until the IPSASB does further work on the measurement of non-contractual payables, at this stage the NZASB supports the application of the IPSAS 19 requirements for the subsequent measurement of non-contractual payables. IPSAS 19 requires provisions to be measured using the best estimate of the expenditure required to settle the present obligation at the reporting date. This is an appropriate measurement for non-contractual payables, and, as noted in the CP, is the approach currently used by some jurisdictions.

Level 2
119 Ghuznee Street
P O Box 9744
Wellington 6141
New Zealand

info@nzonair.govt.nz
www.nzonair.govt.nz

Tel: 04 382 9524
Fax: 04 382 9546

17 November 2017

New Zealand Accounting Standards Board
submissions@xrb.govt.nz

Tenā koutou

BROADCASTING COMMISSION (NZ ON AIR) SUBMISSION:
IPSASB Consultation Paper Accounting for Revenue and Non-Exchange Expenses

The Broadcasting Commission (NZ On Air) is pleased to submit its comments on the International Public Sector Accounting Standards Board's (IPSASB's) Consultation Paper: Accounting for Revenue and Non-Exchange Expenses.

The particular focus of this submission is on the proposed accounting treatment for non-exchange expenses. We are pleased to see this area, previously not explicitly covered in the Public Sector Accounting Standards, clarified. We have some concerns about whether, under the proposed treatment, some public sector financial statements, including NZ On Air's, will present a faithful representation of the effects of transactions, other events and conditions that achieve a fair and meaningful presentation for the users.

We are broadly in agreement with the Public Sector Performance Obligation Approach (PSPOA) proposed in the Consultation Paper. The main focus of this submission is on the definition and application of "performance obligation" with regard to the point of recognising an expense, the need for guidance which reflects the nature of the underlying arrangements and normal practice rather than taking arrangements and contracts at face value, and achieving an approach which provides meaningful information for users.

In preparing this submission, we have consulted with Te Māngai Pāho and the New Zealand Film Commission. We share common concerns about the continuing ability to present financial statements which are meaningful, useful to our users and reflect the underlying reality of our funding expenditure. Many of our interested stakeholders are the same, and comparability both between years and between entities is important. Our financial statements only provide a true reflection of funding expenditure and the use of resources when the expense is recognised on approval rather than based on administrative staging of payments over time, which if taken as the recognition point for the expense, artificially distorts the underlying financial performance and position.

Background
The Broadcasting Commission (NZ On Air) is an autonomous Crown entity under the Crown Entities Act 2004. Our primary job, defined by the Broadcasting Act 1989, is to "reflect and develop New Zealand

identity and culture". We do this by funding different types of New Zealand media content for mainstream and specially targeted audiences to enjoy.

We are driven by public media principles, which include enriching the New Zealand cultural experience, improving diversity of media content in many forms, ensuring content is accessible, strengthening community life, and promoting informed debate.

We achieve this through contestable funding schemes, resulting in investment (funding) of over $127 million each year in diverse content and services for audiences. This is a unique model in the world and gives great flexibility to connect audiences with content, no matter where and how they want to enjoy it.

NZ On Air's main revenue source is Crown revenue (98% of total revenue) through the Arts, Culture and Heritage annual appropriation "Public Broadcasting Services". This is supplemented by a small amount of other revenue, including interest on term deposits and NZ On Air's share of revenue from sales of funded programmes.

NZ On Air's main expense is the funding approved each year (over 97% of expenditure). It is non-exchange expenditure as the funded content is not delivered to NZ On Air but rather to the platform for airing, NZ On Air has no input or editorial rights once funding has been approved, and NZ On Air does not own the funded content.

We report annually on our financial and non-financial achievements. The readers of our annual report include our Board of Directors, Parliament, industry commentators (including journalists), entities receiving or hoping to receive funding, and public media researchers, both in New Zealand and overseas.

NZ On Air's primary objective is to provide services to the New Zealand public and does not operate to make a financial return. NZ On Air has therefore designated itself as a public benefit entity (PBE) and reports under Tier 1 of the PBE accounting standards.

We account for funding expenditure in the statement of comprehensive revenue and expense when the Board has approved the funding, sometimes subject to certain conditions to be cleared before formal contracting. This results in the end of year statements broadly reflecting the level of funding approved in the year compared with the Government appropriation. This information is supported by detailed funding schedules of the projects to which funding has been awarded during the year.

NZ On Air's focus is on presenting financial statements compliant with applicable accounting standards and which meet the needs of our users. Key to achieving this is reflecting funding decisions in the financial statements in a way that can be readily understood by and is meaningful to the users.

Meeting the needs of our users
NZ On Air has a well-established accounting policy for funding expenditure. An extract from our accounting policies is attached in Appendix One.

The resulting financial statements provide information which allows our users to make informed assessments and evaluate how NZ On Air has used its resources. User focus is mainly on the statement of comprehensive revenue and expense, in particular the level of funding approved in the reporting period compared with the level of Crown revenue received. Users give consideration to whether NZ On Air is maintaining levels of funding, how these compare with the annual appropriation (Crown funding) received, how these compare with the budget set by the Board in the annual Statement of Performance

Expectations, published before the start of each financial year, and how these compare with previous years.

In setting and monitoring the annual budget, the Board's focus is likewise on the amount of funding approved compared with the budget set at the start of the year, the remaining budget available for funding and how the funding approved to date achieves NZ On Air's public service objectives.

Equity levels are also of interest to the users. As a Crown-funded organisation not operating to make a financial return and with no borrowings, NZ On Air has no need to maintain significant levels of reserves. The annual budget is usually based on a close-to break even position in order to make maximum possible funding available to applicants to achieve our objectives.

Accounting considerations

To date there has been no clear accounting standard on non-exchange expenses and a lack of clarity about defining and interpreting performance obligations. We note that the Consultation Paper takes a relatively prescriptive approach to what constitutes a performance obligation. However, this does not allow for an entity to reflect the underlying nature of its contracts and transactions, the nature and purpose of the funding, and established practice. Nor does it consider the purpose of the financial statements in the public sector in providing information to the users which is meaningful. Interpreting performance obligations therefore cannot be considered uniform or taken at face value.

NZ On Air's funding expenditure is non-exchange and is recognised as expenditure when:

(a) The funding has been approved by the Board;
(b) The funding recipient has been advised;
(c) There are no substantive contractual conditions for the funding recipients to fulfil; and
(d) It is probable (more likely than not) that the funded proposal will be completed.

The main substantive contractual condition that means a funding commitment cannot be recorded as expenditure is where the Board approval is subject to confirmation of third party funding, and that funding is not in place.

The underlying contract between NZ On Air and the funding recipient generally includes staged payments which are not tied to specified time periods. These are for administrative purposes to manage the cash flows to funding recipients. NZ On Air does not consider these to be substantive conditions in terms of our accounting policy and therefore they are not considered to be performance obligations. The performance obligation is at the point funding has been approved and substantive conditions (of the nature noted above) have been cleared. At this point both the expense and liability are recognised.

Once funding is approved, applicants have a valid expectation that they will receive the approved funding and work commences on the funded project. As in excess of 99% of funded projects are completed, we expect that payment of the approved funding cannot be avoided.

Once approved with substantive conditions cleared (if any), NZ On Air considers that the resources required for the approved funding have been allocated and are no longer available to direct or allocate for any other purpose. In addition, the approved funding contributes to fulfilling our stated objective against the appropriation received for that financial year. Hence the expense should also be recognised.

The effect of our accounting policy and the recognition point for the funding expense is that the statement of comprehensive revenue and expense generally reflects funding approved in the reporting period. Users of the financial statements can see the extent to which NZ On Air has used/allocated the funds it has available for applicants in the period and to achieve its objectives.

In the current environment, applications for available funds are significantly oversubscribed, with a high level of quality applications being declined. Questions are (rightly) raised by applicants, Parliament and the media when available funding has not been, or appears not to have been, fully utilised.

Our aim is to achieve compliant financial statements which present useful and informative information to our readers, and which is also consistent and comparable with previous periods and similar entities in our sector. It is neither meaningful nor useful to report based on when payment stage claims are made as the resources allocated are already no longer available to NZ On Air for any other purpose.

Recognising the expense taking on a strict interpretation of performance obligations based on contractual payment stages would require extensive explanations and reconciliations in the financial statements to explain the underlying position of interest to the user. As well as being confusing to users, it implies a level of obfuscation in our reporting.

A worked example is set out below:

Funding of $4.5m is approved by the Board in March. With no conditions to fulfil before the project can proceed to contract, the entries would be:

<u>Scenario One: Current accounting policy and interpretation of performance obligations</u>

On approval of funding by the Board:

Dr Funding expense	$4.5m	
Cr Funding liability		$4.5m

One payment of $950,000 is made before year end:

Dr Funding liability	$950,000	
Cr Bank		$950,000

The financial statements show an expense of $4.5m and a funding liability of $3.55m at balance date.

Users would see that $4.5m has been approved against the Crown revenue for the year.

<u>Scenario Two: Applying a strict interpretation of performance obligations</u>

On approval of funding by the Board

Dr Funding asset	$4.5m	
Cr Funding liability		$4.5m

As payments are made (one payment of $950,000 is made before year end):

Dr Funding expense	$950,000	
Cr Funding Asset		$950,000
Dr Funding Liability	$950,000	
Cr Bank		$950,000

The financial statements show an expense of $950,000, a funding liability of $3.55m and a funding asset of $3.55m.

Users would see that $950,000 has been approved against the Crown revenue for the year and $3.55m appears to be unallocated, potentially available for funding other projects.

Scenario Two does not present useful information to the users and is potentially misleading. Whilst disclosures would be added to explain the underlying situation, many of our readers do not look beyond the face of the financial statements to notes and explanatory information.

Conclusion

The primary objective of most public sector entities is to deliver services to the public. As a Crown entity, this is NZ On Air's goal, achieved through its funding activities. For decision-making and accountability purposes, users need information on how the resources provided by government have been applied as well as information on the resources available for future use and changes in the entity's ability to provide services (i.e. funding) compared with the previous period and budget. This information is provided through the annual statements of financial position, financial performance and cash flows, together with non-financial performance information.

The focus of users of core public sector financial statements is different to commercial entities. In particular it is on whether the resources provided by the government of the day have been used for their stated purpose. Enabling presentation of this information in a meaningful and informative way should be the focus of the underlying accounting policies. To that end we request that careful consideration be given by the IPSASB to the interpretation of performance obligations and the resulting impact on fair presentation of the underlying transaction.

Any queries about this submission should be directed to our Head of Corporate Services, Clare Helm (clare@nzonair.govt.nz).

Yours sincerely,

Caren Rangi
Chair – Audit and Risk Committee

Appendices

Appendix One: Accounting policies extract (30 June 2017 Annual Report)
Appendix Two: Financial information

2.1 Summary of contract expenditure in 2016/17
2.2 Statement of comprehensive revenue and expense, year ended 30 June 2017
2.3 Statement of financial position as at 30 June 2017

APPENDIX ONE: Accounting policies extract (30 June 2017 Annual Report)

Funding expenditure

Funding expenditure is discretionary funding where NZ On Air has no obligations to award funding on receipt of the funding application. It is recognised as expenditure when:

(a) The funding has been approved by the Board;

(b) The funding recipient has been advised;

(c) There are no substantive contractual conditions for the funding recipient to fulfil; and

(d) It is probable (more likely than not) that the funded proposal will be completed.

<u>Critical judgements in applying this accounting policy</u>

Although from time to time an approved project with no substantive conditions to fulfil does not go ahead, such projects are rare. Based on experience we judge it is probable that all approved commitments at 30 June without substantive contractual conditions to fulfil will be completed.

The main substantive condition that means a funding commitment cannot be recorded as expenditure is where the Board approval is subject to further confirmation of third party funding and that funding is not in place at balance date.

Funding liabilities

We recognise a liability for funding expenditure when the following conditions have been met:

(a) The expenditure has been formally approved

(b) The funding recipient has been advised

(c) There are no substantive contractual conditions for the funding recipient to fulfil

(d) It is probable (more likely than not) that the funded proposal will be completed and that our obligation will crystallise.

At 30 June funding liabilities in the statement of financial position include both contracted liabilities and liabilities that are uncontracted but have no substantive contractual conditions unfulfilled. The amount recorded for the uncontracted liabilities is the amount approved by the Board.

At 30 June therefore, the funding liabilities in the statement of financial position include both contracted liabilities and liabilities that are uncontracted, but have no substantive contractual conditions unfulfilled. The amount recorded for the uncontracted liabilities is the amount approved by the Board.

APPENDIX TWO: Financial information

2.1 Summary of contract expenditure in 2016/17

Funding type and Characteristics	$	%	Liability at 30/6/17 $	Liability at 30/6/16 $
National TV Primarily TV productions and development funding. Includes financial year (FY) funding for TV captioning of $2.8m. No liability for this at 30 June.	79,152	62	26,233	30,400
Regional TV Largely FY funding. $295,000 of the 30 June liability related to contracts specifically covering FY 2014/15.	1,200	1	326	261
Digital Media Mix of project and funding FY e.g. NZ On Screen $1.25m. Liability relates to projects.	3,982	3	1,784	1,343
Public Radio All Radio NZ funding, relates to financial year. No remaining liability at year end.	32,516	26	0	0
Special Interest Radio Mostly Access Radio of approx $5.6m which funds the financial year. No liability for this at year end.	6,281	5	258	406
Music and other content Mix of music recordings and videos and other music. Includes funding on a financial year basis of $469k for The Audience website, liability at 30 June $65k; and alternative radio $920k, liability $187k.	3,946	3	2,468	2,334
Development and support Funding for skills development, sponsorship and events	409	0	167	183
Total	**127,486**	**100%**	**31,236**	**34,927**

2.2 Statement of comprehensive revenue and expense for the year ended 30 June 2017[1]

	Actual 2017 $000	Budget 2017 $000	Actual 2016 $000
Revenue			
Crown revenue	129,426	128,726	128,726
Other revenue	2,514	2,230	2,542
Total revenue	**131,940**	**130,956**	**131,268**
Operating expenditure			
Administration services	3,348	3,715	3,420
Total operating expenditure	**3,348**	**3,715**	**3,420**
Funding expenditure			
Screen content			
National television	79,152	79,300	81,477
Regional media	1,200	1,380	634
Digital-only media	3,982	3,860	3,848
Sound content			
Public radio	32,516	31,816	31,816
Special interest radio	6,281	6,645	6,458
Music and other content	3,946	4,000	3,779
Development & support funding	409	400	397
Total funding expenditure	**127,486**	**127,401**	**128,409**
Total expenditure	**130,834**	**131,116**	**131,829**
Net surplus/(deficit) for the year	**1,106**	**(160)**	**(561)**
Other comprehensive revenue and expense	-	-	-
Total comprehensive revenue and expense	**1,106**	**(160)**	**(561)**

Also noted in the annual report:

"We ended the year with a surplus, due to approved funding of $2.6m being carried into the next financial year for projects where funding conditions were not yet met at 30 June. If all projects had met funding conditions, we would have ended the year with a deficit of $1.5m and equity of $0.5m."

This relates to conditions for funding to proceed not being met where third party funding was not in place at balance date.

[1] A full copy of the 2016/17 annual report can be accessed on line at www.nzonair.govt.nz

2.3 Statement of financial position as at 30 June 2017

	Actual 2017 $000	Budget 2017 $000	Actual 2016 $000
Current assets			
Cash and cash equivalents	5,188	3,000	8,655
Investments	27,000	20,000	28,000
Debtors and other receivables - interest	195	150	178
Debtors and other receivables - other	1,843	150	172
Total current assets	**34,226**	**23,300**	**37,005**
Non-current assets			
Property, plant and equipment	162	350	240
Intangible assets	185	-	12
Total non-current assets	**347**	**350**	**252**
Total assets	**34,573**	**23,650**	**37,257**
Current liabilities			
Trade and other payables	194	300	291
Employee entitlements	121	150	123
Funding liabilities	31,236	23,153	34,927
Total current liabilities	**31,551**	**23,603**	**35,341**
Net assets	**3,022**	**47**	**1,916**
Equity			
Equity at 30 June	3,022	47	1,916
Total Equity	**3,022**	**47**	**1,916**

BDO NEW ZEALAND LIMITED
P O Box 2219
Auckland 1140

20 November 2017

Mr Warren Allen
The Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington
6142

Dear Sir

Requests to comment on Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

Thank you for the opportunity to comment on the above Consultation Paper.

We are making this submission to you to assist the New Zealand Accounting Standards Board (NZASB) with the above Consultation Paper. We are happy for you to publish our comments publically.

In responding we have addressed the specific questions for respondents in Appendix 1.

More information on BDO is provided in Appendix 2 to this letter.

We hope that our responses and comments are helpful. Should you wish to discuss any of the points we have raised please contact me (michael.rondel@bdo.co.nz) should you have any queries or require further information.

Yours faithfully,

BDO New Zealand
Michael Rondel
Audit Technical Director

+64 3 353 5527
michael.rondel@bdo.co.nz

Natalie Tyndall
Head of Financial Reporting

+64 9 373 9051
natalie.tyndall@bdo.co.nz

Appendix 1 – Response to questions

Preliminary View 1 (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.

Yes, we agree with Preliminary View 1.

Moving to revenue recognition based on IFRS 15 will assist with reducing divergence in accounting treatment between public benefit entities (PBEs) and for-profits here in New Zealand.

Preliminary View 2 (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.

Yes, we agree with Preliminary View 2.

Specific Matter for Comment 1 (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 have no comments on taxes with long collection periods.

In terms of social contributions, in the not-for-profit (NFP) sector we have seen significant divergence in practice when entities are receiving funds from the Crown to provide

services to members of the public. There is great confusion as to whether or not these social contributions are exchange or non-exchange in nature and thus whether they are in the scope of PBE IPSAS 9 or PBE IPSAS 23.

In discussing this issue with clients it is clear that they require significant additional guidance on the differences between exchange and non-exchange revenue, and would greatly benefit from having relevant illustrative examples included in this guidance.

We have not identified any other significant areas not covered (elsewhere) by the Consultation Paper.

Preliminary View 3 (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.

Yes, we agree as this approach will lead to consistency of revenue recognition with Category A and Category C transactions. In addition moving revenue recognition for Category B transactions to this approach will reduce divergence between the for-profit and PBE sectors in terms of revenue recognition methodology.

However, we do note that this approach will require a significant amount of education and application guidance (including relevant examples) as this approach requires a completely new approach to accounting for revenue than is currently applied.

We also note that this approach may be considered onerous for smaller Tier 2 NFP entities that do not have significant accounting resources or the funds to outsource the accounting requirements of their organisations.

Specific Matter for Comment 2 (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- Identifying the binding arrangement (paragraphs 4.29 – 4.35);

Step 2 – Identifying 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.

Yes, we agree with the proposals.

Specific Matter for Comment 3 (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 have discussed this issue in detail with a number of our NFP clients.

The vast majority of these clients would favour option (c). These entities believe that a time requirement stipulation results in a constructive obligation to ensure funds are expended in the specified period. Their operational activity is to ensure that revenues received are matched to the related expenses based on the stipulations of the grantor, and that is how they manage their operations and (if applicable) report to the relevant grantor.

These entities believe that option (c) would be easy to implement, cost effective, and would lead to consistency in the sector, even though this option is inconsistent with the IPSASB Conceptual Framework/ PBE Conceptual Framework and IPSAS/PBE Standards.

We would favour option (e) as it is a compromise to following a pure framework definition technical approach such as contained in Option (b).

It will allow entities to "defer" the revenue received from the Category B transactions in other comprehensive income and expense and recycle the revenue to surplus and deficit once the corresponding expenses are incurred, thus allowing entities to "match" the revenue with the corresponding expenses, which appears to be what is desired by these entities.

This option will likely require significant education to be provided as it is a more complex approach and the vast majority of entities in the NFP sector will not have been exposed to option (e) accounting before. However, some of the larger NFP entities that hold financial instruments in the available for sale category will be familiar with this accounting treatment concept and should be able to apply the concepts without significant effort.

Specific Matter for Comment 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.

a) Yes, we agree. There is significant confusion as to the understanding of exchange versus non-exchange transactions and this has led to divergence in practice. Additional guidance is definitely required to explain the difference between exchange and non-exchange transactions if the IPSASB follows Approach 1.

In particular we would encourage the inclusion of specific illustrative examples for common scenarios in the NFP sector, as this will be of invaluable help, especially for the smaller Tier 2 NFP entities.

Preliminary View 4 (following paragraph 5.5)

The IPSASB considers that accounting for capital gains 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 with Preliminary View 4.

Specific Matter for Comment 5 (following paragraph 5.5)

a) Has the IPSASB identified the main issues with capital grants?
If you think 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.

We have not identified any other issues with capital grants and have no other proposals.

Specific Matter for Comment 6 (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 achieved 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 believe that the IPSASB should follow approach (b). However, significant guidance (including relevant illustrative examples) will need to be provided to assist preparers with determining whether measurement can be made such that the qualitative characteristics are achieved.

This is an area where we have seen significant divergence in practice, which is not desirable.

In particular we have seen divergence in the accounting treatment of items such as:

- **peppercorn leases;**
- **loans of artwork for a set period for no consideration;**
- **secretarial services;**
- **accounting services**

which can lead to significantly different accounting results for similar entities.

Preliminary View 5 (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.

Our clients have limited exposure to non-exchange transactions. The Extended Obligating Event Approach is complex and significant education will be required to assist preparers with compliance therewith.

From a New Zealand perspective, we would need more guidance on the likely impact of these requirements (if any) on the not-for profit sector if the IPSASB's proposals are adopted. Significant additional guidance will be required in the not-for-profit sector for non-exchange transactions.

Although we can see benefit, in principal, the IPSASB's preliminary view, we question whether preparers will encounter difficulty in differentiating between exchange and non-exchange expenditure, as they currently do for exchange and non-exchange revenue. We also question whether a better distinction re accounting treatment should rather be based on whether there is an ongoing performance obligation or not.

Preliminary View 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, resource 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.

Please refer to out comment under Preliminary View 5.

Preliminary View 7 (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.

Please refer to out comment under Preliminary View 5.

Preliminary View 8 (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.

Yes, we agree with Preliminary View 8.

Preliminary View 9 (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.

Yes, we agree with Preliminary View 9.

Specific Matter for Comment 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 support (a) as this approach will be relatively straight forward to apply.

Appendix 2 - Information on BDO

1. BDO New Zealand is a network of eleven independently owned accounting practices, with fifteen offices located throughout New Zealand.

2. BDO firms in New Zealand offer a full range of accountancy services, including business advisory, audit, taxation, risk advisory, internal audit, corporate finance, forensic accounting and business recovery and insolvency.

3. BDO in New Zealand has 89 partners and over 800 staff.

4. BDO firms throughout New Zealand have a significant number of clients in the not-for-profit sector.

5. Five BDO firms in New Zealand (BDO Auckland, BDO Christchurch, BDO Northland, BDO Waikato and BDO Wellington) are registered audit firms and thirteen audit partners are licensed auditors.

6. Internationally, BDO is the fifth largest full-service audit, tax and advisory firm in the world, with over 67,700 people in 1,401 offices across over 158 countries and territories.

New Zealand
FILM COMMISSION

Te Tumu Whakaata Taonga

Consultation Paper: Accounting for Revenue and Non-exchange Expenses

Background:

The New Zealand Film Commission (NZFC) is a Crown Entity working to grow the New Zealand film industry. Appropriate accounting treatment of the NZFC's funding commitments is fundamental to the Commission's business objectives.

The NZFC allocates the majority of its annual expenditure to feature film production. It also allocates significant sums to short film production, script development and devolved business development schemes.

It is critical that these funding decisions are reflected in the financial statements in a way that users of the statements can readily understand.

In preparing this submission, we have consulted with Te Māngai Pāho and the New Zealand On Air. We share common concerns about the continuing ability to present financial statements which are meaningful, useful to our users and reflect the underlying reality of our funding expenditure. Many of our interested stakeholders are the same, and comparability both between years and between entities is important. Our financial statements only provide a true reflection of funding expenditure and the use of resources when the expense is recognised on offer and/or acceptance rather than based on administrative staging of payments over time, which, if taken as the recognition point for the expense, artificially distorts the underlying financial performance and position.

Discussion:

<u>Current Accounting Policies:</u>

The NZFC's accounting policy and disclosures for funding, per the Annual Report are:

<u>Grants:</u>

Non-discretionary grants are those grants awarded if the grant application meets the specified criteria and are recognised as expenditure when an application is approved.

Discretionary grants are those grants where the NZFC has no obligation to award on receipt of the grant application and are recognised as expenditure when approved by the relevant NZFC committee and the approval has been communicated to the applicant.

Project commitments:

This amount represents financial commitments and advances for film development, devolved development schemes and production committed by the NZFC, but not paid out at year end.

Users of the Financial Statements

A key objective to the implementation of the PBE IPSAS suite is to provide better information for the users of financial statements.

PBE IPSAS 1 para 15 states:

> *"Financial statements are a structured representation of the financial position and financial performance of an entity. The objectives of general purpose financial statements are to provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making and evaluating decisions about the allocation of resources. Specifically, the objectives of general purpose financial reporting should be to provide information useful for decision making, and to demonstrate the accountability of the entity for the resources entrusted to it, by:*
>
> *(a) Providing information about the sources, allocation, and uses of financial resources;*
>
> *(b) Providing information about how the entity financed its activities and met its cash requirements;*
>
> *(c) Providing information that is useful in evaluating the entity's ability to finance its activities and to meet its liabilities and commitments;*
>
> *(d) Providing information about the financial condition of the entity and changes in it; and*
>
> *(e) Providing aggregate information useful in evaluating the entity's performance in terms of service costs, efficiency, and accomplishments."*

Therefore, it is essential when preparing the NZFC's annual financial statements to ensure they are useful for the readers and key stakeholders (filmmakers, media, Ministers, MCH, MBIE and Parliament). The readers of the NZFC financial statements are most interested in seeing how much money was committed to feature film projects during the year, and also how much money remained unallocated at the end of the year.

In order for the NZFC to provide useful information to the readers of the financial statements, the statements need to reflect the obligations created by the NZFC Board. These obligations are the offer of production funding to applicants, determined at Board meetings. These obligations need to be shown on both the profit and loss and the balance sheet to ensure that closing equity is appropriately stated.

Current Accounting Treatment

All significant feature film production funding decisions are made at Board meetings, which generally take place five times per year. Following each board meeting, a letter of conditional offer is issued to successful applicants. Simultaneously the offer is captured in our financial records.

The current accounting treatment is as follows:

a) the full funding offer is expensed on the profit and loss, and

b) a corresponding liability is recorded on the balance sheet.

This treatment reflects that these funds are effectively ring-fenced for a particular project, and prevents the funds from being utilised elsewhere. The same accounting treatment is applied to funding committed to short film production, script development and devolved business development schemes.

This means that at the end of each financial year, after the annual financial statements have been issued, readers are able to easily see how much money has been committed to funding film projects over the last 12 months, and importantly, how much is left over. They are also able to look at the balance sheet and see how much of the total funds committed by the Commission to film projects remains unpaid.

If management concludes at any point following the issuing of a conditional funding offer that the film project is not able to go forward into production then the funding offer is terminated and the liability and corresponding expense are reversed ("written back"). If the decision to terminate is made in a subsequent financial year to the offer, the writeback is shown as income rather than a negative expense on the profit and loss. Over the last 5 years the percentage of funds written back has averaged 17% of total offers made.

The effect of the consultation paper – a worked through example

The consultation paper sets out two options to record non- exchange expenses. Below we have assessed the impact that each option would have on our film funding process.

EXAMPLE
The NZFC board meets on the 7th December 2017. At the meeting the board considers a production funding request from a producer. The board agrees to provide production funding of $1 million to the film project “XYZ”. Following the board meeting NZFC staff send a letter offering conditional production funding to the producer of “XYZ”. The conditional offer sets out a list of conditions that need to be met in order to “close” (i.e. contract) the film before they are able to start production. It also sets out that the conditional offer will expire in September 2018 unless the film has already closed. The producer of “XYZ” countersigns the offer letter on 20 December 2017 and sets about meeting all the NZFC conditions. This process takes several months. Eventually all the parties involved sign a non-conditional formal production financing agreement on 1 July 2018. This agreement incorporates a finance plan which shows that NZFC will pay $1 million towards the film. An investor funding drawdown schedule is attached as an appendix to the funding agreement. This schedule lists the dates on which each instalment of the $1 million NZFC funding is required to be paid over to the production bank account.

Option 1 – The Extended Obligating Event Approach

Does the NZFC have an obligating event? And if so when does the obligating event arise?

NZFC currently takes the view that as soon as the $1M conditional production funding offer is communicated formally by letter to the producer applicant there is a valid expectation by that producer that they will receive $1 million to help make the film. Therefore, the obligating event arises when the NZFC issues the letter of conditional offer, despite in many cases, the producer not having fulfilled all the conditions set out in the letter at time of issue.

Our interpretation of Option 1 is that the signing of the long-form film funding agreement by all parties would be treated as the obligating event.

At the point of recognising the obligating event, how is it recognised?

The NZFC letter of conditional offer sets out a list of conditions that must be met, before the NZFC funding is able to be released. Therefore, on the 20th^{h} of December 2017 the NZFC would recognise a $1M asset and a $1M liability on its balance sheet. On 1 July 2018 when the formal financing agreement is signed the NZFC would fully expense the $1M funding commitment.

However, if milestone requirements were incorporated into this accounting standard, on 1 July 2018, the NZFC would only be able to recognise an expense to the extent that it is reflected in the drawdown schedule. The expense would be released in line with the drawdown schedule which could potentially be across a period of more than one financial year.

NZFC Comment:

Adopting this approach would create a level of confusion within the NZFC, particularly at board level, as well as amongst our external stakeholders. The NZFC would have to effectively keep two separate sets of books, one for external reporting purposes and one for management purposes. Stakeholders would be confused as they would not be able to tell clearly how much and to what projects the NZFC had conditionally offered funding to.

Requiring milestones to be factored in would increase the ambiguity as to how much had been committed to funding films during any one year. The year-end balance sheet would likely show a misleadingly high equity position. There would be greater variation in the profit and loss account, with some years likely to report large surpluses and other years potentially showing large deficits. Overall, the annual financial statements would be of limited use to readers, with large conditional commitments of NZFC money simply not being fully or clearly reported.

For example, the profit and loss account in the NZFC Annual Report for the year ended 30 June 2016 shows feature film production funding expenditure of $10.9 million. Of this $10.9 million total, $4.35 million was approved at the board meeting in mid-June 2016 and did not have a counter-signed letter of conditional offer at 30 June 2016 meaning it would not meet the expenditure recognition criteria under Option1. Additionally, $4.3 million of funding had not been fully contracted for various reasons. Therefore, ignoring any flow-on impacts from funding offers arising in the previous year, this option would result in the NZFC profit and loss showing funding expenditure of only $2.3 million and an equity increase of $8.6 million. As our total reported expenditure was $22.68 million this would be a very material change to the year-end financial statements.

Option 2 – Public Sector Performance Obligation Approach

Using the same hypothetical example above,

Step 1: Identify the binding agreement – when the producers have countersigned the NZFC letter of conditional offer a binding agreement is entered into by both parties.

Step 2: Identify the performance obligations – a film cannot be broken down into distinct segments. A film only holds value when it is delivered in its entirety. Therefore, for this reason we consider that feature film projects do not have any performance obligations.

Step 3: Determine consideration – the total consideration is $1 million.

Step 4: Allocate the consideration – there is no performance obligations to allocate the consideration against.

Step 5: Recognise the expense – $1 million would be recognised when the conditional offer is agreed/ signed.

NZFC Comment:

It could be argued that the investor drawdown schedule typically attached to the financing agreement sets out performance obligations. The reality is that once a feature film commences production it generally needs to maintain the pre-agreed timetable and complete delivery by the contracted date in order to come in on budget and avoid cost overruns. The NZFC must adhere to the contracted cashflow schedule and release its funds as required to allow the production to be completed on time and on budget. The NZFC has very limited ability to withhold funds, even when producer performance obligations (reporting etc.) are not being met. Any decision by the NZFC to withhold funding to a feature film in production, for whatever reason, would make the completion bond arrangement (essentially an insurance arrangement that guarantees completion of the film in certain circumstances) nul and void.

Conclusion:

The NZFC accepts the need for more clarity and certainty around the accounting for non-exchange expenses. We strongly argue that the proposed new accounting standard needs to ensure that readers of the financial statements can make informed decisions about the organisation.

It is important for the NZFC as a Government funding agency to be able to issue financial statements that are a true representation of financial obligations entered into during the year and that clearly show actual available funds at the end of the year. Substance takes precedence over form.

On this basis, we recommend that the public sector performance obligation approach (Option2) be incorporated into the new accounting standard. This we believe would allow us to continue to prepare annual financial statements that are meaningful to our various external stakeholders, and would avoid unnecessary duplication of accounts internally.

Summary of contract expenditure 2015/16

Funding Type and Characteristics	$	Liability at 30/6/16	Liability at 30/6/15
Production Finance (Recognised when approved by the Board and a conditional offer is sent to the recipient)	10,981,937	11,135,917	14,285,012
Fresh Shorts	641,083	450,500	693,915
Devolved development (boost)	327,240	1,333,900	1,618,250

Warren Allen, Chief Executive
External Reporting Board
Email: submissions@xrb.govt.nz

22 November 2017

Dear Warren

Auckland Council submission to the IPSASB Consultation Paper: Accounting for Revenue and Non-Exchange Expenses

Thank you for the opportunity to comment on the consultation document of the International Public Sector Accounting Standards Board (IPSASB), *Accounting for Revenue and Non-Exchange Expenses*.

Auckland Council is Australasia's largest local government entity and is made up of the Council and six substantive council controlled organisations. We invest heavily in infrastructure and many of our decisions will have a fiscal impact on Auckland's future generations.

We have given our responses to the preliminary views of the IPSASB and the specific questions for the respondents as an attachment to this letter.

Once again, thank you for the opportunity to comment.

Yours sincerely

Kevin Ramsay
General Manager Corporate Finance and Property
AUCKLAND COUNCIL

Gina Cruz
Group Accountant – Policies & Standards
AUCKLAND COUNCIL

Auckland Council
Te Kaunihera o Tāmaki Makaurau

Accounting for Revenue and Non-exchange Expenses Consultation Paper

Attachment – Auckland Council's Responses to Preliminary Views and Specific Matters for Comment

Preliminary View 1

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:

1) Involve the delivery of promised goods or services to customer as defined in IFRS 15; and
2) 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.

Auckland Council Response:

We support the view of the IPSASB that Category C transactions or transactions which involve enforceable agreements, with performance obligations to transfer goods or services to customers on commercial terms should be accounted for under an IPSAS based on IFRS 15 requirements.

We support public sector accounting standards convergence with the private sector's IFRS as Auckland Council Group is a mixed group which means that the entities under the Group are adopting both PBE standards and IFRS. During consolidation, the Group identifies and adjusts differences resulting from being in a mixed group. Thus, for the Auckland Council Group, better convergence of PBE Standards with IFRS means fewer differences or adjustments during consolidation and reporting.

Auckland Council is also a bond issuer in the New Zealand Stock Exchange (NZX), Swiss and Singapore Stock Exchanges. Part of the Group's requirements in the international stock exchanges is to identify differences between the PBE standards adopted by Auckland Council Group and IFRS. Thus, it is helpful for the readers or bondholders of Auckland Council Group's annual report to see no major differences between PBE standards and IFRS.

Preliminary View 2

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.

Auckland Council Response:

We support the preliminary view of the IPSAS to account for those transactions with no performance obligations or non-exchange transactions under an updated IPSAS 23.

Specific Matter for Comment 1

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.

Auckland Council
Te Kaunihera o Tāmaki Makaurau

Accounting for Revenue and Non-exchange Expenses Consultation Paper

Auckland Council Response:
The Group has no major difficulty in applying the requirements of PBE IPSAS 23 since it adopted the PBE Standards to its revenue streams. The one challenge for the Group is the general issue for non-exchange transactions in identifying if a stipulation is a "condition" or a "restriction". The requirements of PBE IPSAS 23 have challenged the "old matching principle" practice as it requires the business to assess if the revenue should be recognised up front or as a liability and be recognised over time.

Accordingly, we encourage the IPSASB to explicitly address the "old matching principle" through disclosure by providing guidance. We are not supportive of allowing entities to defer recognition of revenue unless there is a clear "performance obligation" that is enforceable.

Preliminary View 3
The IPSAB 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.

Auckland Council View:
Yes, we are supportive of this view. Please see our detailed response on revenue recognition in the next page.

Specific Matter for Comment 2
The IPSASB has proposed to broaden 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
Step 2 – Identify the performance obligation
Step 3 – Determine the consideration
Step 4 – Allocate the consideration
Step 5 – Recognise the revenue

Do you agree with the proposals on how each of the IFRS 15 five-steps could be broadened?
If not, please explain your reasons.

Auckland Council Response:
We agree with the proposals on how each of the IFRS 15 five-steps could be broadened especially the "identification of binding arrangement" which considers the public sector transactions and the concept of "performance obligation" which includes a three-party revenue transaction. Please see more details in our response on revenue recognition in the next page.

Specific Matter for Comment 3
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.

Accounting for Revenue and Non-exchange Expenses Consultation Paper

Please explain your reasons.

Auckland Council Response:
Although we consider that these approaches can be used for revenue recognition, we are not entirely supportive of these options. Please see our detailed response on revenue recognition in the next page.

Specific Matter for Comment 4
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.

Auckland Council Response:
Yes, additional guidance on how to assess exchange/non-exchange should be added as it is a significant revenue recognition distinction.

Auckland Council Response on Category B Transactions' Revenue Recognition
Since PBE Standards were adopted by public benefit entities in New Zealand, there have been challenges in assessing what is exchange or non-exchange and if a stipulation is a condition or a restriction. The possibility of convergence with IFRS 15 will add another consideration into the mix which is whether there are performance obligations or not. As an organisation, we will need to continue providing ongoing training to strengthen our finance professional's understanding of the current requirements plus the new requirements. Thus, we strongly encourage the IPSASB and the NZASB (for local requirements) to provide good guidance on the convergence of the old and new standards as part of issuing the new standard. We note that the revenue standard requirements for the public sector are not comparable with the requirements for the for-profit entities due to the non-exchange consideration. The for-profit entities are trying to simplify the revenue standards by consolidating several requirements for recognition into IFRS 15's recognition requirement. The challenge for the IPSASB is to converge with IFRS 15 and at the same time adopt a simplified approach of "how to recognise revenue streams in the public sector".

We would like to dissect some specific matters for comments by the IPSASB in relation to Category B transactions. Category B transactions include those transactions with enforceable agreements, with performance obligations or stipulations to use or consume resources in a particular way; and/or agreement requiring resources to be used over a specified period of time.

Option (b) and (c) - Time requirements as a condition or classify as other obligations
We are not supportive that time requirement should be consider as a condition or classified as other obligations. The time requirement alone is a common restriction in providing or receiving a grant and the common driver of the "old matching principle". We acknowledge that the "old matching principle" is no longer relevant under the new Conceptual Framework and thus, making time requirement as a consideration for not recognising the revenue up front means going back to the "old matching principle".

Accounting for Revenue and Non-exchange Expenses Consultation Paper

Auckland Council Response on Category B Transactions' Revenue Recognition (continued)

We believe that some public or non-for-profit entities receiving grants for multiple periods/years are having problems in preparing their annual report due to difficulty in presenting an imbalance financial performance wherein in the first period an entity reports a large surplus and in the subsequent periods losses are reported. To address this, these entities are already able to provide additional disclosures to explain to readers the multi-year grants under the current PBE Standards. Thus, we support allowing enhanced disclosure in the annual report, however, we acknowledge that merely the requiring additional disclosures option to account for Category B transactions may not meet all users' needs.

Option (e) - Recycling in net assets/equity (other comprehensive revenue and expense) and through statement of financial performance

In New Zealand, public benefit entities are able to use "Other Comprehensive Revenue and Expense". Auckland Council Group has items presented under Other Comprehensive Revenue and Expense such as revaluation gain on property, plant and equipment. We understand that the IPSASB has not introduced Other Comprehensive Revenue and Expense in the Conceptual Framework. We believe that the recycling method through Net Assets or Other Comprehensive Revenue and Expense maybe a neater and more organised approach rather than just merely providing additional disclosures in the annual report. However, we don't consider that the recycling addresses all the judgement considerations surrounding Category B transactions and adding such a consideration in the mix of required revenue recognition requirements does add complexities to the options for revenue recognition. The recycling may address some challenges in terms of timing restrictions.

Public Sector Performance Obligation approach (PSPOA)

Auckland Council supports the "Public Sector Performance Obligation" approach. The introduction of IFRS 15 in the for-profit entities aims to simplify the revenue recognition by focusing on "performance obligation". We believe that the term "performance obligation" can be adopted in the public sector, with some broadened characteristics as compared to the original IFRS 15.

At an overall level, we believe it is easier to assess a revenue transaction with specific recognition criteria in the public sector by focusing on requirements such as *1) non-exchange or exchange* and *2) whether there is a performance obligation or not*. We believe it is easier to assess if a revenue transaction has a performance obligation rather than considering if the stipulation in the agreement is a condition, as this adds complexity.

For example, in considering the revenue recognition of multi-period grants, an assessment should be made if the grant is an exchange or non-exchange. Normally grants are non-exchange as the grantor does not expect the same value in return. Next step for revenue recognition is assessing if there is a performance obligation which will be the driver of how the revenue is recognised either up front or over time. The challenge is in the definition of a performance obligation. We support how the IPSASB in the consultation paper defines a performance obligation. It should be **distinct performance** of either providing goods and/or services so that the revenue can be recognised as the performance obligation is satisfied. Distinct performance means "separately identifiable" in a binding arrangement between parties. For example a distinct performance is "a grant is received by a health clinic to provide vaccination to children in north Auckland" instead of "receiving a grant to fulfil the purpose of the clinic which includes vaccination of children".

Further to multi-year grant revenue which is normally provided by a grantor for the benefit of the public or third parties, we support the IPSASB consideration that in the public sector the revenue transaction is not just a two-party transaction. It could include a third party, for example, there could be a resource provider, resource recipient and beneficiaries. In this case, a performance obligation can be satisfied if the beneficiaries receive the distinct performance agreed between the resource provider and resource recipient.

Auckland Council
Te Kaunihera o Tāmaki Makaurau

Accounting for Revenue and Non-exchange Expenses Consultation Paper

Preliminary View 4
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.

Auckland Council View:
Yes, we support IPSASB's view to explicitly address "capital grants" in the IPSAS.

Specific Matter for Comment 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.

Auckland Council Response on Capital Grant:
Auckland Council and the entities under Auckland Council Group receive capital grants for the ongoing infrastructure requirements in Auckland. Capital grants are part of Auckland Council's revenue streams and one of the biggest revenue streams for individual council-controlled organisations. We do not experience significant issues with revenue recognition of capital grants. Under the current standard, the Group recognises capital grants based on the infrastructure completed during the period since the grantor agrees to provide funding for infrastructure spent during the period. Every period, the entity receiving the funding (cash in arrears) recognises capital grant revenue to the extent of the infrastructure spend during the period. Generally, there is no agreed specific amount to be funded as capital grants and there is no condition to return the funding if the project fails.

However, we noted the issues being raised in the consultation paper such as exchange/non-exchange assessment and the time requirement consideration for multi-year capital grant. We believe that the recognition of capital grants is one example where "a performance obligation" approach can be applied, thus, we support IPSASB's proposal to explicitly address capital grants in the standard and align the revenue requirements for recognition with the proposed changes. We note that when there is an identifiable performance obligation, we are supportive of the "Public Sector Performance Obligation" approach.

Specific Matter for Comment 6
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.

Auckland Council Response:
We support IPSASB's option a above. We don't have material services in-kind received at Auckland Council Group, however, we are of the view that services in-kind should be assess carefully by the entity if there is value in recognition or the constraints under the Conceptual Framework are more prevalent (*materiality, cost-benefit, balance between relevance, timeliness, verifiability, etc).*

Accounting for Revenue and Non-exchange Expenses Consultation Paper

Auckland Council performs accounting services for other related trusts and entities, such as the Independent Maori Statutory Board and other Reserve Boards. There are services Auckland Council provides in-kind to these entities such as IT services, accounting services, and human resources etc. We believe that quantifying these services (and then expensing them) doesn't add much value to these respective financial statements unless the amounts are material. Under the new standard, if the services they received are material to the readers, these can be disclosed in their financial statements and this option is welcomed by the preparers.

Preliminary View 5

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.

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

Auckland Council Response:

We believe that the recognition of expenses should be simplified and should not include significant judgement. In the public sector, there are plans (long-term plan, annual plan, etc) required by the legislation for local government to complete or appropriations for the national government.

In Auckland Council Group, the plans for collective services are commonly approved by the various committees or leaders and are announced to the public. These create expectations and can be considered or assessed as non-legally binding which in our view should not create a liability. However, these plans may change which driven by a change in leadership/political leaders or availability of funding.

The added consideration for non-legally binding obligations under "The Extended Obligating Event" approach creates a difficult judgement exercise for public sector entities. The public sector entity is only certain that these expenses are incurred when the entity entered into a legally binding agreement or the money has been disbursed. The universally accessible services and collective services with no performance obligations should just be simply recognised as incurred.

Preliminary View 6

The IPSASB is of the view that, because there is no obligating event related to non-exchange transactions for universally accessible 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.

Auckland Council Response:

We agree with this view as this is consistent with how revenue is being recognised if there is no condition or performance obligation.

Preliminary View 7

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.

Auckland Council Response:
Those non-exchange expenses with performance obligations should also be accounted for consistently with how the revenue with the same performance obligations is accounted for. This is consistent with the PSPOA approach.

Preliminary View 8
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.

Auckland Council Response:
We are supportive of the preliminary view of the IPSASB on non-contractual receivables. The legislated amount or face (nominal) value, which often equals to fair value of the transaction demands accountability for management. We agree with the proponents of this option (as stated in the consultation paper) that non-contractual receivables such as receivables from rates for Auckland Council is of public interest and therefore the elected officials and the management should be accountable to report this information to the public, who are also readers of the annual report.

With this option, entities such as the Auckland Council Group are able to present the gross amount of the legislated rates and present any further reductions such as impairment. The preparers of the annual report can also present the movement from prior year of both the rates receivables and impairment which can improve the understanding of the readers/users of the annual report.

Preliminary View 9
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.

Auckland Council Response:
We recognise the difficulty of the applying fair value approach to our ordinary receivables. The non-contractual receivables of the Auckland Council Group may include those arising from rates, fines, penalties, etc. Since these receivables are already considered non-contractual determining the market interest rate at each reporting date to calculate the fair value is a challenge. Identifying similar financial instruments with the same terms and risk profile is also a challenge as receivables from revenue transactions arising from legislative power is not common in the market.

We believe that it is easier to adopt the "cost approach" or lower of carrying value and recoverable amount. We support the consultation paper's assessed advantage of avoiding what are likely to be potentially arbitrary decision on market interest rates. On the other hand, the preparers are still able to use the "discounting of cash flows" and assessment of proper interest rates in determining the recoverable amount.

The cost approach doesn't add too much complexity in determining the subsequent measurement of simple receivables such as licenses, fines and penalties, etc.

Accounting for Revenue and Non-exchange Expenses Consultation Paper

Specific Matter for Comment 7

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.

Auckland Council Response:

We believe that it would be easier to apply the Cost of Fulfilment approach as it requires a best estimate of the amount required to settle the liability, using the discounted cash flows approach where appropriate.

It is also consistent with the requirements of IPSAS 19 which is the best estimate of the expenditure required to settle the present obligation at reporting date which also considers the time value of money.

22 November 2017

New Zealand Accounting Standards Board
submissions@xrb.govt.nz

Tēnā koe koutou

TE REO WHAKAPUAKI IRIRANGI (TE MĀNGAI PĀHO) SUBMISSION: IPSASB Consultation Paper Accounting for Revenue and Non-Exchange Expenses

Te Reo Whakapuaki Irirangi (operating as Te Māngai Pāho) is pleased to provide its comments on the International Public Sector Accounting Standards Board's (IPSASB's) Consultation Paper: Accounting for Revenue and Non-Exchange Expenses.

The focus of this submission is on the proposed accounting treatment for non-exchange expenses. As a result of discussions with our auditor, we have significant concerns that the application of the proposed accounting treatment for the recognition of expenditure will render our reporting to the users of our financial statements confusing and misleading.

This concern centres on the definition and application of what constitutes a "performance obligation" under the Public Sector Performance Obligation Approach (PSPOA), when used to establish the point at which to recognise an expense and the need for clarity to distinguish between an obligating event and administrative arrangements within an established contract. Taking a form over substance approach will yield accounting results which will not tell users of our financial statements what they want to know or provide what they have been accustomed to receiving.

In preparing this submission, we have consulted with NZ On Air and the New Zealand Film Commission. We share common concerns about the continuing ability to present financial statements which are meaningful, useful to our users and reflect the underlying reality of our funding expenditure. Many of our interested stakeholders are the same, and comparability both between years and between entities is important. Our financial statements only provide a true reflection of funding expenditure and the use of resources when the expense is recognised on approval rather than based on administrative staging of payments over time, which, if taken as the recognition point for the expense, artificially distorts the underlying financial performance and position.

Background

Te Māngai Pāho is an autonomous Crown Entity established to promote Māori language and culture through making content available for the online, broadcast and music sectors. The entity is funded by Parliament through Vote Māori Affairs and is accountable for its conduct and performance to the Minister for Māori Development.

The relevant legislation governing Te Māngai Pāho's operations includes the Broadcasting Act 1989, the Crown Entities Act 2004 and Te Ture mō Te Reo Māori 2016.

The primary function of Te Māngai Pāho is to promote the Māori language and Māori culture by making funds available for broadcasting, the production of programmes to be broadcast and archiving programmes. As a secondary function Te Māngai Pāho may also make funds available for transmitting on demand, producing content for transmitting on demand and archiving content.

In the exercise of these functions Te Māngai Pāho will consult from time to time with representatives of Māori interests, broadcasters and others who, in the opinion of Te Māngai Pāho, can assist in the development of funding policies.

Te Māngai Pāho funds the national network of Māori radio stations and the production and broadcast of radio and television programmes, new media, music tracks and videos. It also funds the archiving of content.

Te Māngai Pāho has designated itself as a public benefit entity (PBE) for financial reporting purposes and does not operate to make a financial return.

Te Māngai Pāho's programme funding is non-exchange expenditure.

Te Māngai Pāho operates in a contestable funding environment and as such, funding applicants are eager to receive information on what projects were funded and for how much, as they try to determine evolving trends and benchmarks.

Relating to the User Experience

Our area of work is the funding of content that will best appeal to its intended target audience. With the growth of digital platforms for launching content, increasingly the factors used in decision making for the allocation of funding centre on consideration of the "User Experience" or UX in the jargon.

Equally in the reporting of our activities, there should also be a focus very much on the User Experience. Consideration should be given to the sort of information that the user expects, wants and needs. Our financial statements are our accountability documents to Parliament and the New Zealand taxpayer, and are also sought by people and entities involved in the broadcasting and media sector. Te Māngai Pāho emphasises transparency and accountability as part of our values and we wish to remain to be seen as transparent and accountable in the way that information is presented to users of our financial statements.

Accounting Treatment

Contestable funding is let through a series of Request for Proposals (RFP) funding rounds during the year. Once the round closes, applications received are considered by an assessment committee which makes recommendations to the Board. Funding rounds are generally considerably oversubscribed so that there is high interest in the results of the round.

The Board has the final say on the projects that will receive funding. Successful projects receive a Letter of Offer (which may be conditional or unconditional).

Once the production company accepts the Letter of Offer (and fulfils the conditions if applicable) the accounting treatment would be to expense the full amount of the project in the Income and Expenditure Statement and raise a corresponding liability in the Statement of Financial Position.

Our view is that once the applicant accepts the Letter of Offer and meets any conditions, this is the obligating event for Te Māngai Pāho and the applicant has a valid expectation of entitlement to the full amount of the funding.

Our concern is that there could be an interpretation that the various administrative milestones attached to the contract, individually form separate obligating events, so that expenditure in this view would only be recognised incrementally.

This could create accounts that would show that Te Māngai Pāho had not allocated all the available funding in the year or, conversely, that it was operating a deficit due to the carry over of transactions from the previous year.

The impact of changes to the way in which funding might be recognised in Te Māngai Pāho's accounts is demonstrated by the following example, using a television funding contract.

Example: TV Production Drama contract

Current Treatment

As an example, assume that in October 2016, the Board approved an unconditional contract for a television production drama for $2.3 million.

The entries would be:

Dr Funding Expense	$2.3 million	
Cr Funding Liability		$2.3 million

Before year end, payments of $1.1 million were paid out under the contract.

Dr Funding Liability	$1.1 million	
Cr Bank		$1.1 million

In the annual financial statements at 30 June 2017, there would be an expense of $2.3 million and a funding liability of $1.2 million. Interested readers of the accounts could see the full value of the contract in the accounts and, together with all other contracts treated in a similar way, that Te Māngai Pāho had allocated all available funding in the year (which is always our aim). This is important for both the government who entrusted us with the funds for distribution and for funding applicants and broadcasters who would see that available funding had been used.

Applying a Strict Performance Obligation Definition

Applying a strict interpretation of the performance obligation definition, entries would be as follows:

On acceptance:

Dr Funding Asset	$2.3 million	
Cr Funding Liability		$2.3 million

Payments made before year end:

Dr Funding Expense	$1.1 million	
Cr Funding Asset		$1.1 million

Dr Funding Liability	$1.1 million	
Cr Bank		$1.1 million

The annual financial statements would show an expense of $1.1 million, a funding asset of $1.2 million and a funding liability of $1.2 million. The accounts would seem to indicate that only $1.1 million had been expensed and there remained a further $1.2 million yet to be allocated.

Conclusion

Presenting meaningful information to the users of the financial statements should drive the choice of accounting treatment. Te Māngai Pāho contracts include milestones that have been worded in such a way to provide levers to ensure delivery but this is simply to ensure public money is wisely spent.

While Te Māngai Pāho supports the adoption of the Public Sector Performance Obligation Approach, there is a possibility that adoption of a narrow interpretation of obligating events would create unintended consequences. Without such accommodation, future financial statements for entities in our sector would become increasingly opaque and result in avoidable confusion and misinformation.

Together with similar agencies in our sector, Te Māngai Pāho asks the Board to give consideration for scope to broaden the guidance around the determination of an obligating event in order that we might continue to meet the needs of the users of our financial statements.

Should you have any questions regarding this submission, please contact our Manager Corporate Services, Thomas Hood (Thomas@tmp.govt.nz).

Nāku noa, nā

Larry Parr
Kaihautū-Chief Executive

APPENDIX ONE: ACCOUNTING POLICIES EXTRACT

Funding Expenditure

The allocation of funds to broadcasting projects is recognised as expenditure in the financial year the allocation is made provided that, prior to the end of the financial year, the project has received Board approval and the funding applicant has received notice of approval in writing. Expenditure therefore includes funds allocated but not paid out at year end. The funds not paid out are recorded as funding liabilities in the statement of financial liability. This liability is reduced as the applicant is paid according to the drawdown schedule specified in the production contract.

Critical judgements in applying accounting policies

Te Māngai Pāho has exercised judgement in developing its funding expenditure accounting policy above, as there is no specific accounting standard for funding expenditure.

Te Māngai Pāho is of the view that once the conditions in the policy have been met, the funding recipient has a valid expectation that funding will be paid, and that is the point at which expenditure is recognised. Any milestones included in underlying contracts are for administrative purposes only.

With the recent introduction of the new PBE accounting standards there has been debate on the appropriate framework to apply when accounting for such expenditure. Te Māngai Pāho is aware that the need for a clear standard or authoritative guidance on accounting for funding expenditure has been raised with the New Zealand Accounting Standards Board and will consider any developments.

Funding Liabilities

At the time projects are approved by the Board of Te Māngai Pāho and notification is made to the funding recipient, expenditure is charged against the current year's income and recorded as a liability. The liability is reduced as the funding recipient is paid according to the drawdown schedule specified in the funding contract. It is expected that the majority of these liabilities will be paid

APPENDIX TWO: SUMMARY OF CONTRACT EXPENDITURE 2016/17

Funding Type	$m	%	Liability as at 30/6/17	Liability as at 30/6/16
Direct Funding of Māori Television	16.1 m	30%		
TV Programmes, Digital Initiatives and other	24.6 m	45%		
Television			$13.9 m	$13.3 m
Iwi Station Operational Funding	10.5 m	19%		
Radio Programmes, Music and Video s	2.0 m	4%		
Other	$1.2 m	2%		
Radio and Music			$1.4 m	$0.9 m
Total	**$54.4 m**	**100%**	**$15.3 m**	**$14.2 m**

Level 1, 100 Molesworth Street
Thorndon, Wellington
PO Box 99, Wellington 6140

04 496 3099

www.auditnz.govt.nz

3 December 2017

Warren Allen
Chief Executive
External Reporting Board
PO Box 11250
Manners St Central
Wellington 6142

Dear Warren

IPSASB Consultation Paper *Accounting for Revenue and Non-Exchange Expenses*

We appreciate the opportunity to comment to the NZASB on the IPSASB's Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (the CP). We also appreciated the opportunity to participate at the NZASB Working Group meetings on the CP.

The accounting for revenue and non-exchange expenses is a challenging and important area in public sector accounting. We are pleased the IPSASB is progressing the development of improved revenue standards and a standard on public sector expenses.

We are concerned that moving away from the "condition" accounting approach of IPSAS 23 to a "performance obligation" approach as proposed under the PSPOA could result in revenue being recognised earlier, despite an expectation from the funder that the entity perform an enforceable task or deliverable. We consider the performance obligation notion of the PSPOA needs to be broadened further than proposed by the IPSASB to capture those transactions that do not transfer a good or service but there is an enforceable obligation on the grant recipient to perform a specific task or deliverable.

If the PSPOA is not broadened further, we expect it would give rise to issues similar to time-requirement issues experienced under IPSAS 23. If the IPSASB decides not to broaden the PSPOA, then it should consider broadening the time-requirement options to also cover arrangements with deliverables imposed by the funder that are enforceable but don't involve the transfer of a good or service.

A number of the issues identified by the CP for grant recipients are also relevant to grant providers. We recommend the IPSASB also consider the accounting for capital grants and time-requirements from the grant provider's perspective.

Our responses to the IPSASB's Preliminary Views and Specific Matters for Comment are attached.

We plan to provide a separate submission to the IPSASB on the CP.

If you would like to discuss any of our comments, please phone me on 021 222 6247 or email me at brett.story@auditnz.govt.nz.

Yours sincerely

Brett Story
Associate Director, Technical

Our comments on the Consultation Paper

Preliminary View 1

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.

We generally agree. However, our preference is that transactions within the scope of the PSPOA are addressed in an IFRS 15-equivalent standard that is amended for the PSPOA, rather than as a separate standard or part of an amended IPSAS 23.

Preliminary View 2

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.

Yes, we agree.

Specific Matter for Comment 1

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.

An issue encountered with IPSAS 23 is determining when a receivable asset arises under a grant arrangement.

IPSAS 23 provides limited guidance on asset recognition and measurement for grant arrangements. Determining the asset recognition and measurement accounting for grant arrangements can be challenging when grant funds are paid over time and future payments are conditional on the grantee performing an action or reaching a specified milestone. In such examples, the grantee's performance may or may not be wholly within their control.

It would be helpful if further guidance was provided on when the funding under a grant arrangement meets the asset recognition criteria and the measurement of that asset.

Further application issues in the context of related SMC and PVs questions are addressed in the relevant sections of this comment letter.

Preliminary View 3

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.

We generally agree with the IPSASB developing a PSPOA approach. However, we consider a broader notion of "performance obligation" needs to be developed. This is discussed further in our comments in SMC 2 below.

For those transactions with "time-based" stipulations that would not qualify for the PSPOA, the IPSASB needs to consider the accounting options included in SMC 3 below. Under the CP, the IPSASB proposes only to consider time-based stipulations under Approach 1 of enhancing IPSAS 23. The IPSASB should also consider time-based stipulations under Approach 2 of the PSPOA as the issue is relevant under both approaches.

Specific Matter for Comment 2

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 have a significant concern with step 2 – identify the performance obligation.

Paragraph 4.46 of the CP explains that a performance obligation only includes activities that an entity must undertake to fulfil a contract and where those activities transfer a good or service to a customer. The IPSASB considers this principle would need to be preserved in developing a broadened PSPOA.

We are concerned that the IPSASB intends to develop a broadened PSPOA with a performance obligation notion that is too narrow and would apply only where a funding contract results in a good or service being transferred to a funder or beneficiary. This may result in some transactions that include conditions (and therefore revenue deferrals may be recognised under IPSAS 23) no longer being eligible for revenue deferral under a broadened PSPOA.

We consider a contract that includes specific deliverables and is enforceable by the funder that does not involve the transfer of a distinct good or service to the funder/beneficiary should be eligible for accounting under the PSPOA. This is because in substance it is sufficiently similar to an enforceable obligation imposed by a funder to transfer a good or service.

For example, a District Health Board (DHB) enters into a 2 year multi-year grant agreement totalling $800k to fund the salary costs for a project manager and support staff to review the DHBs systems and processes to improve cancer treatment times and then implement system improvements. The DHB is required to report quarterly to the funder on progress on the project deliverables and salary costs incurred. Funds are provided quarterly in advance subsequent to the receipt of the prior quarter's quarterly report and unspent funds are refundable to the funder at the end of the arrangement. The funder has the ability to cancel the contract or cease future payments in the event of non-performance under the contract.

This example raises the issue of when an asset arises under the contract and the amount of that asset, and when revenue is recognised following recognition of the asset.

In this example, the DHB is required to perform a specific task, which is monitored by the funder and is enforceable. Satisfying the performance expected in the funding arrangement also requires an economic outflow in the form of future salary costs.

This example also illustrates that while there may not be an immediate directly observable output to a beneficiary, the expenditure is contributing to an outcome of improving treatment times. This would be of general benefit to users of the public health system.

We therefore consider this type of arrangement should be accounted for following the PSPOA framework because in substance it is sufficiently similar to an obligation imposed by the funder to transfer a good or service.

We urge the IPSASB to develop a broadened PSPOA that is broad enough to capture those contracts with clear deliverables imposed by the funder that are enforceable but don't involve the transfer of a distinct good or service to a funder/beneficiary.

If the PSPOA is not broadened further, we expect issues will emerge similar to time-requirement issues experienced under IPSAS 23. If the IPSASB does not broaden the PSPOA as recommended, the time-requirement options in SMC 3 below should be broadened to apply to contracts with deliverables imposed by the funder that are enforceable but don't involve the transfer of a distinct good or service to a funder/beneficiary.

Specific Matter for Comment 3

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.

The options to address concerns around time-requirements should also be considered by the IPSASB in implementing Approach 2, the PSPOA.

The accounting for funding that includes time-requirements is an important issue for affected entities due to the significant distortions that can arise in the reported financial performance. Distortions can arise when an entity is required to recognise the following year's operating funding grant when it is unconditionally agreed prior to that period, or where an entity receives a multi-year grant and is required to record revenue upfront for the full amount of the grant in advance of the costs incurred.

An example of such an issue in New Zealand is the Waikato River Clean-Up Trust where the Trust will receive $7 million each year for 22 years. The Trust intends to disburse the funding annually on river clean-up related grants. Because the funding arrangement is unconditional, the funding to be received over the 22-year period is recognised as a receivable and revenue upfront when the agreement was executed. The funds received will then be expensed over the 22-year period as grant arrangements are entered into by the Trust. In this example, the Trust also reports a significant amount of interest revenue to unwind the discounted value of the receivable over the 22-year period, which further distorts the Trust's financial performance.

If the IPSASB decides on a recognition solution for time-requirements, we prefer option (e) of transferring the credit entry to net assets and recycling to the surplus/deficit in the period the funding relates to. Sufficient guidance would need to be provided under this option on the timing of the recycling of the credit entry to the statement of financial performance to mitigate manipulation of performance. We note there is precedent for this accounting approach in IPSAS 29 under cash flow hedge accounting where derivative gains and losses are deferred in equity and recycled to the surplus/deficit to match the revenue or expense arising from the risk managed.

Specific Matter for Comment 4

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. If the IPSASB decides to progress Approach 1, then we consider further guidance is necessary in distinguishing between exchange and non-exchange transactions. The most difficult and time consuming aspect of the transition to the new PBE Accounting Standards was assessing whether a revenue transaction was exchange or non-exchange due to the lack of guidance in this area. Further guidance on the exchange/non-exchange distinction would therefore be welcomed under Approach 1.

Preliminary View 4

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 the accounting for capital grants should be explicitly addressed within IPSAS.

We have encountered significant issues and challenges in accounting for capital grants received by entities in applying IPSAS 23.

The IPSASB should also address capital grants from the funder's perspective.

Specific Matter for Comment 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 main issues we are aware of have been identified.

(b) We are disappointed the IPSASB has not identified proposals for constituents to comment on.

Our preference is for the IPSASB to develop proposed requirements and guidance for capital grant transactions based on application of the PSPOA. The proposals would need to address difficult capital grant issues, such as:

- Where an entity has a use condition on an asset, and, if it breaches this condition, the grantor can request the return of the physical asset or refund all or part of the grant monies provided. For example, a capital grant provided that must be used to construct social housing and the asset must be used for social housing purposes for 20 years, and, if breached, all or part of the grant monies are repayable to the transferor.

- A use condition is attached to an asset with an indefinite life and the asset must be returned to the transferor if that condition is breached. For example, land held that must be used indefinitely for agricultural use.

We encourage the IPSASB to consider the capital grant requirements and guidance developed by the Australian Accounting Standards Board in AASB 1058 *Income of Not-for-Profit Entities*, in particular paragraphs 15 to 17, and illustrative examples 9 and 10.

Requirements and guidance for entities that **provide** capital grants should also be considered by the IPSASB as it develops the non-exchange expense accounting proposals as providers of capital grants are faced with similar accounting issues as grant recipients.

Specific Matter for Comment 6

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 support retaining the existing requirements that permit entities to make an accounting policy choice for the recognition of services-in-kind.

In the public sector, most entities do not recognise services-in kind received. We are not aware of any concerns by public sector entities about the existing service-in kind accounting requirements.

We expect, in most cases, the cost of obtaining information on the value of services-in kind received would outweigh the benefits received from reporting this information. Mandating the recognition of services-in kind would require entities to establish systems and processes to gather reliable information, such as establishing time sheeting systems, systems to estimate the value of the services received, and internal controls over these to ensure the information is reliable and auditable.

Preparers are also unlikely to see any significant benefits associated with the time and cost of establishing and maintaining service-in kind systems. For example, mandating the recognition of services-in kind may require schools to estimate a monetary value for members of the community who "donate" their time to various school activities, such as coaching, fundraising, working-bee activities, and other activities of the school.

Additionally, we anticipate there could be difficulty in determining whether an entity has sufficient control for accounting purposes over an individual in assessing whether an asset arises from the services-in kind received.

Preliminary View 5

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.

The CP acknowledges that universally accessible services and collective services contain no performance obligations or stipulations that the resource recipient is required to fulfil as a result of receiving these services.

Given there are no performance obligations on service recipients, there appears to be little merit in considering application of an <u>extended</u> obligating event approach.

We consider the important issue for the IPSASB to address is the liability recognition point for universally accessible and collective services as this drives the expense recognition.

Preliminary View 6

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.

While we are comfortable with the accounting outcome of universally accessible services and collective services liabilities and expenses being recognised when incurred, the IPSASB needs to provide further reasons and analysis to support this conclusion.

The CP justifies there is no obligating event in relation to universally accessible services and collective services because governments can vary the level of such services so that the availability of those services may be limited. We don't think this fact is persuasive in its own right to support the conclusion reached. We note that adjusting the levels of services provided by a government is unlikely to occur swiftly and may require legislative change for rights to services established through legislation.

The IPSASB should consider the work in the Social Benefits project to strengthen the support for the PV.

Preliminary View 7

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 generally agree with this PV. However, we consider:

- The performance obligation definition needs to be broader than proposed by the IPSASB, for the same reasons as explained in SMC 2 above.

- The IPSASB also considers time-requirements and capital grant accounting for grant providers, as noted in PV 4 and SMC 3 above.

We also consider that sufficient guidance needs to be provided on the liability recognition point for all grants, contributions, and other transfers (regardless of the approach applied to expense recognition). An issue often encountered in practice with these arrangements is when a present obligation to provide funding arises. Particularly, when grant funds are paid over time and future payments are conditional on the grantee performing an action or reaching a specified milestone.

Preliminary view 8

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.

Yes, we agree.

The initial measurement of statutory receivables, such as taxes and fines, at fair value was subject to significant debate between some preparers and auditors on transition to IPSAS 23. In particular, there was tension between the requirements of IPSAS 23 and concerns over the loss of important information on statutory imposed revenue amounts by applying a fair value measurement approach at initial recognition.

Initially recognising non-contractual receivables at face value with a separate impairment amount would help provide greater transparency and accountability for statutory-based revenues.

Preliminary View 9

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.

Yes, we agree. We favour this approach over amortised cost and cost as it should generally be the simplest of the 3 proposed methods to apply in practice.

Entities that hold non-contractual receivables often have a large number of debtors with small amounts in the context of the overall portfolio balance. These portfolios are not managed based on credit risks and therefore have different characteristics to commercial receivable portfolios.

We anticipate it would be unduly complex and costly to apply the amortised cost approach to large statutory receivables portfolios where discounting is required. It may also be unworkable to apply the IFRS 9 expected credit loss impairment model without practical expedients given the large volume and the nature of statutory receivables.

The cost approach also seems problematic as it would be difficult to determine when a debtor is impaired or when a past impairment is reversed within a large portfolio.

While there could be more volatility in the statement of financial performance arising from discount rate changes under a fair value approach, this doesn't seem to have been a significant issue for those New Zealand entities that have applied a subsequent measurement model that is similar to fair value.

Specific Matter for Comment 7

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 the IPSAS 19 approach as that approach appears to more closely align to the fair value approach for non-contractual receivables.

The CP is unclear on what the practical difference is between the cost of fulfilment approach and the IPSAS 19 approach above as both approaches are based on discounted cash outflows. If the IPSASB considers there is a practical difference between approaches (a) and (d) above, it would be helpful for that to be explained in the future exposure draft if different options are being considered.

Our preference is to follow an approach that closely aligns with the subsequent measurement requirements of non-contractual receivables. Different subsequent measurement approaches between receivables and payables is likely to be confusing for preparers and users of financial statements and could require different systems. This is likely to be a concern for entities that report both non-contractual receivables and payables for the same tax. For example, the Inland Revenue Department and Financial Statements of Government report both tax related receivables and payables in the statement of financial position as the Government can owe and be owed amounts related to income tax and GST (and the position of the respective taxpayers could change year-on-year).

We think there would need to be a compelling reason to apply different subsequent measurement bases for non-contractual receivables and payables.