Supporting papers February 2019

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EXTERNAL REPORTING BOARD

Te Kāwai Ārahi Pūrongo Mōwaho

Policy Approach to Developing the Suite of PBE Standards

Originally Issued September 2013

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Approved by the XRB Board for application by the New Zealand Accounting Standards Board from 1 January 2019

Preface

1. In May 2013, the New Zealand Accounting Standards Board (NZASB) issued the PBE Standards – a new suite of standards for Tier 1 and Tier 2 public benefit entities. That initial set of standards, developed in accordance with the External Reporting Board's (XRB Board's) *New Zealand Accounting Standards Framework*, can be regarded as the "foundation suite" of PBE Standards. It is expected that the foundation suite will be enhanced and developed over time.

2. This *Policy Approach to Developing the Suite of PBE Standards* (the PBE Policy Approach) has been developed by the XRB Board and the NZASB to assist the NZASB in making consistent decisions when developing the suite of PBE Standards i.e. when considering enhancements and developments to the suite of PBE Standards in the future.

3. While primarily based on International Public Sector Accounting Standards, the foundation suite of PBE Standards was developed using a range of source standards: International Public Sector Accounting Standards, selected NZ IFRSs and domestic standards developed within New Zealand. Developments are likely to arise from each of these sources as changes are made to the international standards and as issues specific to New Zealand emerge.

4. Without a policy such as this, it would be possible for significant fluctuations in the NZASB's approach to developing the suite of PBE Standards to emerge over time. This PBE Policy Approach therefore provides constituents with some certainty about the likely future direction of the suite of PBE Standards, and provides a basis for assessing proposals for changes to the PBE Standards as they are issued by the NZASB. It also assists constituents to understand the likely implications of future changes to the suite of PBE Standards for public benefit entities (PBE) groups containing for-profit entities (commonly referred to as "mixed groups").

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The Development Principle

In accordance with the *New Zealand Accounting Standards Framework*, the primary purpose of developing the suite of PBE Standards is to better meet the needs of the PBE user groups (as a whole). In considering whether to initiate a development, the NZASB shall consider the following factors:

(a) Whether the potential development will lead to higher quality financial reporting by public sector PBEs and not-for-profit (NFP) PBEs, including public sector PBE groups and NFP groups, than would be the case if the development was not made; and

(b) Whether the benefits of a potential development will outweigh the costs, considering as a minimum:

   (i) *relevance to the PBE sector as a whole*: for example, where the potential development arises from the issue of a new or amended IFRS® Standard, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;[1]

   (ii) *relevance to the not-for-profit or public sector sub-sectors*: whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;

   (iii) *coherence*: the impact on the entire suite of PBE Standards (e.g. can the change be adopted without destroying the coherence of the suite);

   (iv) *the impact on mixed groups*; and

(c) In the case of a potential development arising from the issue of a new or amended IFRS Standard, the IPSASB's likely response to the change (e.g. whether the IPSASB is developing an IPSAS on the topic).

Application of the Development Principle

The PBE Policy Approach includes a series of rebuttable presumptions in applying the development principle:

(a) The NZASB will adopt a new or amended IPSAS.

(b) The NZASB will not include an IFRS Standard that the IASB has issued on a new topic in the suite of PBE Standards unless the IPSASB addresses the issue.

(c) In considering the impact on PBE Standards from a change to an NZ IFRS that relates to a topic for which there is an existing PBE Standard based on an IPSAS, the NZASB will consider the factors in the development principle in determining whether to initiate the development of a related change to the PBE Standards ahead of the IPSASB. Particular emphasis in this case needs to be placed on the IPSASB's likely response to the change and whether the IPSASB will address the change in an acceptable time frame.

(d) The NZASB will not incorporate minor amendments to NZ IFRS into the equivalent PBE Standard in advance of the IPSASB considering the change. However, the

[1] This policy 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).

NZASB may issue an exposure draft that proposes the incorporation of these minor amendments into the equivalent PBE Standards at the same time as the IPSASB issues an exposure draft that proposes the incorporation of these minor amendments into IPSAS.

1. Introduction

1. The PBE Policy Approach addresses the NZASB's approach to developing and enhancing the suite of PBE Standards. References to PBEs in this Policy include references to all PBEs: public sector PBEs and NFP PBEs, and public sector PBE groups and NFP PBE groups.

2. Triggers for possible changes to the PBE Standards are likely to come from three sources:

   (a) the IPSASB issuing a new IPSAS or a change to an existing IPSAS (section 4.1);

   (b) the IASB issuing a new IFRS Standard or a change to an existing IFRS Standard (section 4.2); and

   (c) domestic developments within New Zealand, including both exogenous events such as changes to the legislative framework and endogenous events where the NZASB considers that developments are warranted (section 4.3).

3. The PBE Policy Approach considers the implications of the *New Zealand Accounting Standards Framework* for developing the suite of PBE Standards and identifies an approach to be taken for each of the triggers for possible changes to PBE Standards.

2. Basis for Development of PBE Standards

4. The multi-standards approach in the *New Zealand Accounting Standards Framework* (issued in April 2012 and updated in December 2015) is designed to better meet the needs of users of the financial statements of PBEs.[2] Accounting Standards for Tier1 and Tier 2 entities are based on IPSAS.

> 57. An explicit part of the multi-standards approach is the adoption of a set of accounting standards for PBEs other than one based on IFRS.
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> 58. The only set of international accounting standards, other than IFRS, is IPSAS. IPSAS provides a better basis for PBE reporting for entities in Tier 1 and Tier 2 than does IFRS because it is developed for a wider set of users, notably service recipients as well as resource providers.
>
> 59. The XRB also considers that IPSAS is a credible set of standards. The historical concerns about IPSAS had been the lack of a conceptual framework and the lack of independent governance arrangements for IPSASB (at least compared to those applying to the IASB). These concerns have been addressed by both the IPSASB and the International Federation of Accountants (IFAC – the IPSASB's parent body). The IPSASB issued its conceptual framework General Purpose Financial Reporting by Public Sector Entities in late 2014 and an independent governance body for the IPSASB has been established for the first time in 2015.
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> 60. However, the XRB continues to consider that it is premature to adopt "pure" IPSAS (in the way that NZ IFRS reflects "pure" IFRS). This is because, among other matters, the IPSAS is developed for public sector entities and the requirements are not always appropriate for not-for-profit entities or do not necessarily fit with the New Zealand regulatory environment. Moreover, IPSAS does not currently represent a complete set of standards. Therefore, a set of PBE Standards has been developed that uses IPSAS as their base. PBE Standards modify IPSAS for any recognition, measurement or disclosure matters considered inappropriate in New Zealand. Such modifications are only made where the IPSAS requirement in question has a material impact on the financial position or performance being reported, and that impact would adversely detract from the financial statements' usefulness to users.
>
> 61. Since the adoption of the initial Accounting Standards Framework, the XRB, in conjunction with its sub-Board, the New Zealand Accounting Standards Board (NZASB), has developed (and issued in September 2013) a *Policy Approach to Developing the Suite of PBE Standards* [footnote omitted]. The Policy Approach establishes an approach, based on a "development principle" and a series of "rebuttable presumptions", which are used by the NZASB to determine whether, and when, to make changes to PBE Standards.
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> 62. PBE Standards include other relevant standards (including domestic standards) appropriate for New Zealand and/or to address topics not covered in IPSAS.
>
> 63. The PBE Standards are also modified to make them relevant, applicable and understandable to the not-for-profit sector preparers and users. Some modification is desirable to enhance their usefulness in the not-for-profit context.
>
> (*New Zealand Accounting Standards Framework*, paragraphs 57–63)

5. The PBE Policy Approach uses the term "development" to encompass any change to the suite of PBE Standards.

6. In considering the appropriateness of potential developments of the suite of PBE Standards, it is necessary to consider these developments in the context of the *New Zealand Accounting Standards Framework*, including the impact of any

[2] The New Zealand Accounting Standards Frameworks is available at https://www.xrb.govt.nz/reporting-requirements/accounting-standards-framework/

developments on the quality of the financial reporting arising from those standards and the trade-off between the benefits of improvements in the quality of the resulting financial reports and the associated costs.

2.1 Quality of Financial Reporting

7. The suite of PBE Standards is designed to meet users' needs by providing high quality financial reporting by PBEs. It follows that any development of PBE Standards should aim to improve the quality of financial reporting. The quality of financial reporting relies on meeting the needs of users of PBE general purpose financial reports (including financial statements), while endeavouring to ensure that the costs arising from a development do not outweigh the benefits.

8. In this context, high quality financial reporting is assessed by reference to the conceptual framework for PBEs (as it applies from time to time), with primary emphasis on the objective of financial reporting and then the qualitative characteristics. A standard is more likely to lead to higher quality financial reporting if it adheres closely to the conceptual framework.

9. The categories of users of financial statements of PBEs and for-profit entities are different. Paragraph 1.2 of the New Zealand Equivalent to the IASB *Conceptual Framework for Financial Reporting* (2018 *NZ Conceptual Framework*) identifies users of financial statements as suppliers of resources to the entity, and notes that the decisions that they make are related to providing resources to the entity.

10. In contrast, paragraphs 2.1–2.4 of the *PBE Conceptual Framework* (the New Zealand equivalent of the IPSASB *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*) considers a wider group of users of financial reports, being resource providers and service recipients and their representatives., and notes that information is needed for both accountability and decision-making purposes.

11. A development of the suite of PBE Standards will improve the quality of financial reports prepared in compliance with PBE Standards if it improves the accounting for specific transactions by better meeting the objective of financial reporting and the associated qualitative characteristics of financial reporting.

12. Further, high quality financial reporting depends on consistent treatment of similar transactions. For example, it would usually be inappropriate to require different measurement for similar liabilities in similar circumstances. As a result, any development of PBE Standards (including the conceptual framework for PBEs) should ensure that the suite is maintained as a coherent whole.

13. It follows that any developments should ensure that the needs of users are better met than they were prior to the development. Alternatively, the cost-benefit test (see next section) may be met where the needs of users are equally as well served, with a consequent benefit in some other way such as a reduction in the costs of preparing the financial statements.

2.2 Costs and Benefits

14. In considering a potential development of the suite of PBE Standards, the primary purpose and benefit is to improve the information provided to users of PBE financial reports.

15. Benefits need to be considered in relation to the suite of PBE Standards as a whole, in addition to the implications for a specific area of financial reporting. The benefit of aligning the PBE Standards with NZ IFRS to the extent possible is that this will reduce differences between the financial statements of PBEs and for-profit entities. This benefit is particularly relevant to entities that are members of mixed groups and users of PBE financial statements whose familiarity with financial statements arises from experience in the for-profit sector.[3] However, for other preparers that are not part of a mixed group, there may be additional preparation costs as a result of changes in accounting standards that might not otherwise arise.

16. The PBE Standards are largely based on IPSAS in accordance with the *New Zealand Accounting Standards Framework* and, therefore, careful consideration is required before making any change to a PBE Standard based on an IPSAS in circumstances other than as a consequence of the IPSASB issuing a new or amended IPSAS (as discussed further below in paragraph 29). In addition, the benefit of using IPSAS to the extent possible is that IPSAS are a suite of standards that comprise a coherent package. It also reduces standard-setting costs as the IPSASB documents are readily available for application in New Zealand with little additional work. Reducing the time spent on setting the base standards releases resources for working with the international standard setters and for necessary domestic projects.

17. In developing a coherent suite of PBE Standards, it will generally be relatively low cost to add additional guidance for all PBEs, or for sub-groups of PBEs such as NFP entities. However, it is expected that recognition and measurement requirements will be common to all PBEs. Further, using recognition and measurement requirements developed from a number of sources creates the potential for inconsistencies within the suite of PBE Standards, such as applying different measurement requirements to similar liabilities. Care should be taken to minimise the impact of such inconsistencies, if they cannot be eliminated.

18. At times, there is a tension between reducing the costs borne by preparers within mixed groups – that is the elimination of differences between PBE Standards and NZ IFRS that are not sector specific – and improving the suite of PBE Standards taken as a whole. This Policy takes the view that reducing the costs on preparers within mixed groups should be considered to the extent that these costs can be reduced whilst meeting the needs of the wider range of users of financial statements of public sector PBEs and NFP PBEs (including public sector and NFP groups) through a complete and coherent suite of PBE Standards.

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[3] For the purposes of the PBE Policy Approach, a mixed group is a PBE group that includes at least one material for-profit subsidiary where that for-profit subsidiary applies accounting policies that differ from those of the mixed group and that may need to be adjusted under the consolidation standards.

3. The Development Principle

19. In accordance with the *New Zealand Accounting Standards Framework*, the primary purpose of developing the suite of PBE Standards is to better meet the needs of PBE user groups (as a whole). In considering whether to initiate a development, the NZASB shall consider the following factors:

(a) Whether the potential development will lead to higher quality financial reporting by public sector PBEs and NFP PBEs, including public sector PBE groups NFP PBE groups, than would be the case if the development was not made; and

(b) Whether the benefits of a potential development will outweigh the costs, considering as a minimum:

(i) *relevance to the PBE sector as a whole:* for example, where the potential development arises from the issue of a new or amended IFRS Standard, whether the type and incidence of the affected transactions in the PBE sector are similar to the type and incidence of the transactions addressed in the change to the NZ IFRS;

(ii) *relevance to the NFP or public sector sub-sectors:* whether there are specific user needs in either of the sub-sectors, noting that IPSAS are developed to meet the needs of users of the financial reports of public sector entities;

(iii) *coherence:* the impact on the entire suite of PBE Standards (e.g. can the change be adopted without destroying the coherence of the suite);

(iv) *the impact on mixed groups*; and

(c) In the case of a potential development arising from the issue of a new or amended IFRS Standard, the IPSASB's likely response to the change (e.g. whether the IPSASB is expected to develop an IPSAS on the topic in an acceptable time frame).

20. The NZASB will need to exercise its judgement in balancing the factors in the development principle because, in many cases, there will need to be a trade-off between these factors. This policy provides a basis for making such a trade-off decision: it cannot replace the application of judgement by the NZASB with a series of bright-line rules.

4. Application of the Development Principle

21. The following sections are designed to assist in the application of the factors in the development principle. They consider, in turn, potential developments of the suite of PBE Standards that might arise from developments in IPSAS and NZ IFRS as well as addressing issues that might arise within New Zealand. Although the PBE Policy Approach treats each of these developments separately, it is likely that specific developments will need to be considered from a number of perspectives. For example, the NZASB may have planned to continue to update PBE IAS 34 *Interim Financial Reporting* in line with developments of NZ IAS 34 *Interim Financial Reporting* to retain consistent interim reporting across all sectors (section 4.2). However, if the IPSASB were to issue a standard addressing interim reporting, this new IPSAS would be considered as a development resulting from an enhancement to IPSAS (section 4.1).

4.1 New or Amended IPSAS

22. There is a rebuttable presumption that the NZASB will adopt a new or amended IPSAS.

23. This rebuttable presumption is based on the expectation that the IPSASB has considered the needs of the wide range of users of public sector financial statements in developing and enhancing the suite of IPSAS. Therefore, it is expected that such changes will lead to higher quality financial reporting by PBEs in New Zealand and the factors in the development principle are presumed to be met.

24. Depending on the circumstances, it may be appropriate to apply one of the following approaches when a new or amended IPSAS is issued:

    (a) Amend a recently issued or newly amended IPSAS in the process of adoption in New Zealand. Examples of possible amendments include:

        (i) improving the quality of the IPSAS in the New Zealand context by, for example, adding guidance or making changes to enhance the clarity and consistency of the requirements to enable public sector PBEs and NFP PBEs to apply the standard consistently;

        (ii) adding guidance to assist NFP PBEs in applying the standard, given that the standard has been developed for application by public sector PBEs;

        (iii) amending as necessary to maintain the coherence of the suite of PBE Standards;

        (iv) excluding options that are not relevant in the New Zealand context; or

        (v) amending the scope of an IPSAS if the IPSAS conflicts with a legislative requirement, or a legislative requirement addresses the same issue for public sector entities. However, in these circumstances, it may be appropriate to adopt the IPSAS for NFP PBEs.

    (b) Rebut the presumption in paragraph 22 and thereby not adopt a new or amended IPSAS, or part(s) thereof. Given that PBE Standards are based primarily on IPSAS, a decision to rebut the presumption is expected to occur only in exceptional circumstances. Examples of such circumstances include where the NZASB has significant concerns that, in the New Zealand context:

(i) adoption of a new or amended IPSAS would not be either appropriate or relevant (based on the development priniciple); and

(ii) the costs of adoption of a new or amended IPSAS would outweigh the benefits.

25. In the event that the presumption to adopt a new or amended IPSAS is rebutted, this will require the NZASB to report to the XRB Board:

(a) its decision and rationale for the decision; and

(b) what, if any, action(s) it plans to take in relation to the new or amended IPSAS, for example, whether a domestic standard will be developed and whether parts of the new or amended IPSAS will be incorporated into that domestic standard.

4.2 New or Amended NZ IFRS

26. New or amended NZ IFRS will require the NZASB to consider whether to initiate a development of the PBE Standards in the following circumstances:[4]

(a) an IFRS Standard that the IPSASB has used as the basis for an IPSAS is changed;

(b) the IASB issues an IFRS Standard on a new topic; and

(c) there is a change to an NZ IFRS that has been used as the basis for a PBE Standard.[5]

4.2.1 An IFRS Standard that the IPSASB has used as the basis for an IPSAS is changed

27. As noted earlier, the PBE Standards are primarily based on IPSAS. In turn, many IPSAS are primarily based on IFRS Standards. Examples of such standards are PBE IPSAS 16 *Investment Property* and PBE IPSAS 17 *Property, Plant and Equipment*, which are based on IAS 40 *Investment Property* and IAS 16 *Property, Plant and Equipment*, respectively. Accordingly, there are likely to be many instances in which a new or amended NZ IFRS relates to a topic covered by an existing IPSAS standard that has been incorporated into the PBE Standards.

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[4] An amendment to an NZ IFRS can fall into more than one of the above categories, for example, an NZ IFRS on a new topic might also result in changes to other NZ IFRS that fall into category (a) and/or (c).

[5] NZ IFRS that the NZASB has included in the suite of PBE Standards are:

- PBE IFRS 3 *Business Combinations*
- PBE IFRS 4 *Insurance Contracts*
- PBE IFRS 5 *Non-current Assets Held For Sale and Discontinued Operations*
- PBE IAS 12 *Income Taxes*
- PBE IAS 34 *Interim Financial Reporting*
- NZ IFRIC 12 *Service Concession Arrangements* and NZ-SIC 29 *Service Concession Arrangements: Disclosures* (which are the basis for PBE FRS 45 *Service Concession Arrangements: Operator*).

28. **In considering a change to an NZ IFRS that relates to a topic for which there is an existing PBE Standard based on an IPSAS, the NZASB will consider the factors in the development principle in determining whether to initiate a development of the PBE Standards. Particular emphasis in this case needs to be placed on the IPSASB's likely response to the change, including whether the IPSASB is expected to address the change in an acceptable timeframe.**

29. Given the presumption in paragraph 22 that any IPSAS issued by the IPSASB will be included in the PBE Standards, there are considerable potential costs and risks associated with "getting ahead of the IPSASB". Therefore, the NZASB needs to decide whether to develop a PBE Standard ahead of the IPSASB or to wait for the IPSASB's response. If the issue is already on the IPSASB's active work plan, the NZASB would normally wait for the IPSASB to complete its work, unless the NZASB is of the view that there is an urgent need for action in New Zealand or the NZASB is of the view that the IPSAS is unlikely to be appropriate in the New Zealand context.

30. **Furthermore, in the case of limited-scope amendments or amendments to an NZ IFRS that the NZASB considers are minor, there is a rebuttable presumption that the change should not be incorporated into the equivalent PBE Standard in advance of the IPSASB considering the change.** This is because minor amendments are less likely to meet the cost-benefit test, particularly when the potential costs and risks associated with getting ahead of the IPSASB are taken into account. However, the NZASB may issue an exposure draft that proposes the incorporation of these minor amendments into the equivalent PBE Standards at the same time as the IPSASB issues an exposure draft that proposes the incorporation of these minor amendments into IPSAS.

31. Where there is a major change to an IFRS Standard for which there is an existing IPSAS and where the IPSASB is unlikely to address the change in an acceptable time frame, the NZASB could either develop a domestic modification to the PBE Standard or assist the IPSASB to develop an IPSAS. Options for assisting the IPSASB include offering to provide staff resources for the IPSASB or partnering with the IPSASB to update a specific IPSAS in the light of the major change. It may be more effective to assist the IPSASB because any uncertainties about the IPSASB's approach to the issue will be resolved sooner rather than later. However, the level of effort required to develop an IPSAS based on an IFRS Standard for international use is likely to be significantly higher than developing a PBE Standard based on an IFRS Standard or its equivalent NZ IFRS for use in New Zealand. The IPSASB's due process, multi-constituency reach and less regular meetings leads to a standards development process for the IPSASB that is more time consuming and complex.

4.2.2 The IASB issues an IFRS Standard on a new topic

32. An example of a new topic is where the IASB is considering issuing a standard on rate-regulated activities.

33. There is a rebuttable presumption that the NZASB will not include an NZ IFRS that the IASB has issued on a new topic in the suite of PBE Standards unless the IPSASB addresses the issue.

34. As noted in paragraph 26, some NZ IFRS were included in the suite of PBE Standards to maintain current practice until the IPSASB addresses the related issues. This rationale does not apply to an NZ IFRS on a new topic. Also, given the PBE Standards are primarily based on IPSAS in accordance with the *New Zealand Accounting Standards Framework*, adding further PBE Standards based on NZ IFRS is unlikely to be consistent with the objectives of that Framework.

35. In considering whether to rebut the presumption, the NZASB should consider whether the new standard both leads to a major improvement in the quality of financial reporting and fills a gap in the suite of PBE Standards (as distinct from a gap in NZ IFRS). This is unlikely to arise.

4.2.3 An NZ IFRS that the NZASB has included in the PBE Standards is changed

36. The NZASB has included selected NZ IFRS in the suite of PBE Standards (see footnote 7) in order to maintain current practice until the IPSASB addresses the related issues.

37. In considering a change to an NZ IFRS that is included in the suite of PBE Standards, the NZASB shall consider the factors in the development principle in determining whether to initiate a development of the PBE Standards.

38. However, in situations where there is no equivalent IPSAS on the topic and the IPSASB is not expected to create such a standard in the foreseeable future, the IPSASB’s likely response to the change would be less relevant. This will impact on the overall assessment of the costs and benefits of including the NZ IFRS development in the PBE Standards. This is because the potential problems associated with “getting ahead of the IPSASB” (as discussed in paragraph 29 above) are less likely to arise.

39. An implication of this policy is that those PBE Standards based on an NZ IFRS (see footnote 7) may need to be updated or replaced to align with the current equivalent NZ IFRS.

4.3 Domestic Developments

40. Domestic developments include developing standards to meet specific requirements in New Zealand.

41. The suite of PBE Standards contains standards directly addressing issues relevant to New Zealand, including PBE FRS 42 *Prospective Financial Statements*, PBE FRS 43 *Summary Financial Statements* and PBE FRS 48 *Service Performance Reporting*. Further domestic standards may be developed where a need arises when an issue of importance in New Zealand is not addressed in a standard issued by the IPSASB (section 4.1) or the IASB (section 4.2).

42. In determining whether to initiate the development of a domestic standard for inclusion in the PBE Standards, the NZASB will consider the factors in the development principle. Assuming the NZASB determines that the development of a domestic standard would improve the quality of financial reporting by PBEs, the NZASB will first consider whether there is an international pronouncement addressing the relevant issue that is applicable in the New Zealand context.

43. The *New Zealand Accounting Standards Framework* presumes that New Zealand will be a standards taker rather than a standards maker whenever possible, for a range of reasons, including:

    (a) the quality derived by an international due process;

    (b) the prospect of international comparability; and

    (c) the limited resources available for the domestic development of standards.

44. It follows that the NZASB will develop domestic standards or guidance that result in a material improvement in information available to users of financial statements when:

    (a) there is no other source of material available internationally; or

    (b) the available international guidance is not targeted specifically towards addressing New Zealand issues.

EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho

NZ ACCOUNTING STANDARDS BOARD

28 March 2018

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Submitted to: www.ifac.org

Dear John

ED 63 *Social Benefits*

Thank you for the opportunity to comment on ED 63 *Social Benefits* (ED 63). The ED has been exposed in New Zealand and some New Zealand constituents may comment directly to you.

We have begun by outlining the key points in our comment letter.

We consider that there are no significant conceptual differences between the types of transactions that would fall within the scope of Exposure Draft 63 *Social Benefits* and universally accessible services and collective services. In our opinion 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. Our preferred option is that a standard on social benefits would cover both cash benefits and services provided to beneficiaries. However, we acknowledge that from a standard-setting perspective, the IPSASB may wish concentrate on a subset of transactions.

If the IPSASB proceeds on the basis of the proposed scope in ED 63 we would 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. Our ultimate aim would be for a consistent and coherent approach to accounting for social benefits, regardless of their form. We have also put forward a suggestion to simplify the scope requirements.

We support the application of the insurance approach to insurance-like activities. We have some suggestions to refine the criteria for application of this approach and have asked the IPSASB to consider the appropriateness of the risk adjustment requirements in IFRS 17 for public sector entities. In our view the obligating event approach is not appropriate for insurance-like activities. These liabilities should be recognised either in accordance with IFRS 17 *Insurance Contracts* or using guidance based on the requirements in IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.

Regarding the proposals in ED 63 on the obligating event approach, our overall view is that to meet the objectives of general purpose financial reporting in accordance with the qualitative characteristics and pervasive constraints discussed in *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, it is necessary to consider how obligations for future benefits are managed. In the case of schemes which are managed in the same way as an insurer would manage its insurance contracts and which are substantially fully funded, we consider that it is appropriate to report both the assets and liabilities associated with that activity. In the case of other benefits which are not managed in this way and which are to be funded through future taxes, the recognition of large liabilities for social benefits, without the recognition of future cash flows that will fund those benefits, is unlikely to result in financial statements that meet the objectives of general purpose financial reporting and satisfy the qualitative characteristics.

We are broadly supportive of the proposed disclosure requirements in ED 63. However, we do not support the requirement to disclose five years of projected cash outflows. We ask that the IPSASB reconsider whether this requirement satisfies the objective of the disclosures, as outlined in the IPSASB's Basis for Conclusions. We also have concerns that some of the proposed requirements will increase the length of financial statements. We support the recent focus on trying to limit the length of financial statements and keep disclosures understandable and accessible and have therefore made some suggestions about ways to manage the extra information being considered by the IPSASB.

We consider that RPG 1 *Reporting on the Long-Term Sustainability of an Entity's Finances* is serving a useful role, but should remain as guidance at this time.

Our recommendations and responses to the Specific Matters for Comment are set out in Appendix 1 to this letter. If you have any queries or require clarification of any matters in this letter, please contact Lisa Kelsey (Lisa.Kelsey@xrb.govt.nz) or me.

Yours sincerely

Kimberley Crook
Chair – New Zealand Accounting Standards Board

Appendix 1: Responses to Specific Questions for Comment

Specific Matter for Comment 1: Do you agree with the scope of this Exposure Draft, and specifically the exclusion of universally accessible services for the reasons given in paragraph BC21(c)? If not, what changes to the scope would you make?

<u>Definition of a social benefit</u>

We acknowledge that the definition of a "social benefit" is a key determinant of what is in or out of the scope of ED 63. We have found the definition problematic to apply in practice and have commented on the proposed definition under SMC2 below.

<u>Universally accessible services</u>

We do not agree with the exclusion of universally accessible services from the scope of the ED.

We have recently commented on the IPSASB's Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (the CP). In that comment letter we noted that the determination of an obligating event for social benefit schemes is not substantively different from the determination of an obligating event for general obligations to provide services to the public, including collective services and universally accessible services.

Similar issues arise in respect of these general obligations to provide services to the public as are being considered in ED 63. 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 people aged 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 obligations for benefits to be provided in the form of money (for example, national superannuation) or in the form of services (for examples, education services). Accordingly, issues being discussed in ED 63 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, we consider 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. Our preferred option is that a standard on social benefits would cover both cash benefits and services provided to beneficiaries. However, we acknowledge that from a standard-setting perspective, the IPSASB may wish concentrate on a subset of transactions at this stage. If the IPSASB proceeds with the proposed scope in ED 63 we would 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.

Social risks and other risks

We disagree with the argument in paragraph BC21(b) that social risks and other risks (for example, earthquakes and flooding) are different. Governments do react to specific disasters, but they may also have standing benefits available for natural disasters. For example, New Zealand farmers affected by an adverse event (for example, flood or drought) which is classed as medium or large-scale by the Minister for Primary Industries, may qualify for a Rural Assistance Payment. Although the severity of the adverse event has to be assessed, the benefit is a standing benefit to deal with the social risks resulting from the adverse event.

Artificial boundary

The IPSASB has acknowledged in paragraph BC21(c) that social benefits and non-exchange expenses fall along a continuum, and that any boundary between these two categories of expenses will, to some extent, be artificial. In creating separate standards for the spectrum of public sector expenses, we are concerned that there may be a risk that some schemes might have multiple components, only some of which fall within the scope of ED 63.

Transaction versus scheme

We note that the scope paragraph (paragraph 5) refers to a transaction but the rest of the [draft] standard establishes requirements for schemes. The [draft] standard does not define a scheme. We do not think that this is a major issue, but some acknowledgment of the fact that social benefits are frequently administered, or referred to, as schemes, or some discussion of what is meant by a scheme would be helpful.

Suggested changes to scope

While we would prefer that the standard on social benefits dealt with social benefits in their entirety (including universally accessible services), we acknowledge that the IPSASB may wish to deal with a subset of social benefits (that is, those that are paid directly to beneficiaries).

We suggest that if the IPSASB wish to deal with a subset of social benefits then the scope of the standard should be limited to those social benefits that are paid directly to eligible beneficiaries.

IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*

We note that the IPSASB will need to ensure that the current scope exemption for provisions and contingent liabilities arising from social benefits in IPSAS 19 will work with the final standard on social benefits. At present IPSAS 19 has a fairly wide scope exclusion in relation to social benefits. It appears that only some of these social benefits will fall within the scope of a standard on social benefits. In order to maintain the status quo, IPSAS 19 will still need to exclude those social benefits not covered by a standard on social benefits.

Specific Matter for Comment 2:
Do you agree with the definitions of social benefits, social risks and universally accessible services that are included in this Exposure Draft?
If not, what changes to the definitions would you make?

Definitions

We have found the definitions contained in ED 63 problematic to apply in practice. We are still not convinced that consistency with the classification system used by GFS is the best driver for establishing the scope of an IPSAS. In particular, we have struggled with applying the concept of 'social risk' and why some risks are social risks and others are not. The concept of social risk is not well understood by the accounting community in all jurisdictions and the interpretation of this term could lead to diversity in practice. Some of the questions or issues we have faced in trying to apply the definitions to particular benefits are as follows.

- The diagram under IG2 says universal education does not mitigate the effect of social risk. However, we are of the view that free education reduces the risk of unemployment and note that employment status is considered a social risk. We also note that having to pay for education would impose additional demands on household resources.
- Paragraph AG7 states that "Where benefits in kind are universally accessible, for example a universal healthcare service, these do not meet the definition of a social benefit for the purposes of this [draft] standard." This is open to interpretation because, in order to meet the current definition in ED 63 for universally accessible services, the eligibility criteria cannot be related to social risk. Poor health is a social risk and an individual would have to have a health issue to be eligible to access the universal healthcare services.
- We are not clear what is meant by "address the needs of society as a whole" in the social benefits definition.
- We do not see the rationale for distinguishing between aid provided immediately after an earthquake and the subsequent unemployment benefits or housing benefits paid to people who have lost their jobs or home because of an earthquake (see paragraph AG10).

If the IPSASB were to change the scope as we have suggested in SMC1 above (see *Suggested changes to scope*) we do not think any of these definitions would be required.

Specific Matter for Comment 3:
Do you agree that, with respect to the insurance approach:

(a) It should be optional;

(b) The criteria for determining whether the insurance approach may be applied are appropriate;

(c) Directing preparers to follow the relevant international or national accounting standard dealing with insurance contracts (IFRS 17, *Insurance Contracts* and national standards that have adopted substantially the same principles as IFRS 17) is appropriate; and

(d) The additional disclosures required by paragraph 12 of this Exposure Draft are appropriate?

If not, how do you think the insurance approach should be applied?

<u>Response to SMC3(a)</u>

SMC3(a) Do you agree that, with respect to the insurance approach, it should be optional?

We do not agree that the insurance approach should be optional. We support the use of the insurance approach for schemes that are managed in the same way as insurance obligations, as the insurance approach aligns the reporting with the management of such schemes. If such schemes were permitted to use the obligating event approach this would result in material understatement of an entity's liabilities.

The obligating events approach and the insurance approach are almost at opposite ends of the spectrum in terms of the liabilities that would be recognised. In the case of a scheme which pays for long-term injury treatment following an accident, the insurance approach would require recognition of a liability for treatment over the remainder of a person's life, but the obligating event approach would require the recognition of a liability up until the next revalidation point only. The difference in the amounts recognised under each approach could be material for both the entity and any whole of government statements into which the entity is consolidated.

Entities that manage large social benefit schemes often want to benchmark their performance against similar international schemes. Consistent accounting is necessary for benchmarking to be possible.

The arguments considered by the IPSASB in deciding to make the insurance approach optional are set out in paragraphs BC35 to BC41 of ED 63. Although the IPSASB has considered arguments both for and against making the insurance approach optional, cost seems to have been the main reason for deciding that it should be optional, with the difficulty of applying the criteria a secondary consideration. We do not agree that the cost of applying the insurance approach should be used to justify making this approach optional. Significant liabilities and significant risks should be accounted for appropriately.

The arguments considered by the IPSASB in deciding to propose the use of the obligating events approach for social benefits in general are set out in paragraphs BC59 to BC89. One of the key factors that seemed to influence the IPSASB's thinking was the difficulty of determining that there has been a past event that has given rise to a liability. In the case of obligations for benefits that would meet the criteria to be accounted for using the insurance approach this argument is not relevant. In the case of such liabilities there is general agreement that there has been a past event that has given rise to a liability.

In our view, entities with insurance-like liabilities should be required to recognise such liabilities, either in accordance with IFRS 17 (our preference) or a simplified approach developed by the IPSASB. We explain this in more detail in the next paragraph.

If, after considering responses on ED 63, the IPSASB remains concerned about the cost of mandatory application of IFRS 17 requirements, it could include simplified insurance approach requirements directly in a social benefits standard. These requirements could be based on the requirements for the recognition of provisions in IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. This approach would result in some differences compared to the application of IFRS 17, but we consider that such differences would be more justifiable than permitting non-recognition of liabilities that are generally agreed to be liabilities. We have identified the following differences that would need to be considered if the IPSASB were to develop such requirements.

(a) IFRS 17 requires outstanding claims to be measured as the central estimate of the present value of expected future payments with an additional risk adjustment. The additional risk adjustment is the compensation an entity requires for bearing the uncertainty about the amount and timing of future cash flows arising from non-financial risk as the entity fulfils insurance contracts. IPSAS 19 does not require a risk adjustment for inherent uncertainty.

(b) The discount rate requirements differ. IFRS 17 requires that the discount rates applied to the estimate of cash flows shall: (a) reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts; (b) be consistent with observable market prices of those financial instruments whose cash flow characteristics are consistent with those of the insurance contracts; and (c) exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts. IPSAS 19 requires the use of a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the liability.

(c) IFRS 17 includes presentation and disclosure requirements designed specifically to cater for insurance activities, such as disclosures around claim development. IPSAS 19 does not.

<u>Response to SMC3(b)</u>

SMC3(b) Do you agree that, with respect to the insurance approach, the criteria for determining whether the insurance approach may be applied are appropriate?

We support the criterion in paragraph 9(b) that the entity must manage the scheme in the same way as an insurer would manage its insurance contracts. Our view is that entities engaged in insurance-like activities should report on them in the same way as insurers.

We do not support the criterion in paragraph 9(a) that the social benefit scheme is *intended to be* fully funded from contributions. Although we agree that this would be a desirable characteristic of schemes (and in most cases the criterion would be satisfied by an entity wanting to use the insurance approach), we consider that how the entity manages the scheme is more important than whether or not it is fully funded.

We note that the Australian Accounting Standards Board (AASB) has recently considered similar issues in developing its Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures* *and Public Sector Entities* (November 2017).[1] The AASB considered and rejected full funding as a scope criterion. The AASB noted that this would not be consistent with other accounting standards or its Conceptual Framework as these pronouncements do not treat the ability to fund a liability as the determinant or limiter on whether a liability is recognised. We concur with this point.

We also think there could be practical difficulties in applying the fully funded criterion in paragraph 9(a). For example, most components of a scheme may be fully funded, but one or more components may not. Paragraphs 9 and A13 talk about "a scheme", but do not indicate whether the assessment is carried out with respect to an entire scheme including all its components, or for each individual component. We assume that schemes which are intended to be fully funded from a certain date would meet the criterion.

In relation to the examples we have considered in New Zealand, the Accident Compensation Corporation, which currently applies insurance accounting, has one component which is not fully funded. This component has been accounted for consistently with the other components and the assessment of future levies for this component is based in part on the liabilities recognised in the financial statements. If the accounting for this component were to change from an insurance approach to the obligating event approach it would have a dramatic impact on the amount of the liability recognised in the financial statements and could send the wrong signals about future funding requirements.

As a way forward, we suggest that the IPSASB consider:

(a) changing the order of paragraphs 9(a) and 9(b) to highlight the importance of how a scheme is managed; and

(b) rephrasing what is currently paragraph 9(a) so that it refers to social benefit schemes which are <u>substantively</u> fully funded from contributions.

In making this suggestion we have thought about how any components of a scheme that will not be fully funded would be accounted for under IFRS 17. IFRS 17 (paragraph 47) states that "An insurance contract is onerous at the date of initial recognition if the fulfilment cash flows allocated to the contract, any previously recognised acquisition cash flows and any cash flows arising from the contract at the date of initial recognition in total are a net outflow." IFRS 17 requires that an entity identify onerous contracts at initial recognition. The entity is required to recognise losses on onerous contracts immediately in profit or loss. The entity does not recognise any contractual service margin on the balance sheet on initial recognition of an onerous contract. We are of the view that the onerous contracts requirements in IFRS 17 would result in appropriate accounting for such components.

1 The AASB issued this Discussion Paper in November 2017. The AASB is seeking feedback on proposals to modify AASB 17 *Insurance Contracts* to lead to more consistent reporting of public sector insurance liabilities.

Response to SMC3(c)

SMC3(c) Do you agree that, with respect to the insurance approach, directing preparers to follow the relevant international or national accounting standard dealing with insurance contracts (IFRS 17, Insurance Contracts *and national standards that have adopted substantially the same principles as IFRS 17) is appropriate?*

We are broadly in agreement with the IPSASB's proposal to direct entities to IFRS 17 or national equivalents. Our main concern is whether the risk adjustment requirements in IFRS 17 are appropriate for public sector entities. The Basis for Conclusions that accompanies ED 63 (paragraphs BC51 to BC54) outlines the IPSASB's consideration of whether or not entities applying the insurance approach should be required to include a risk adjustment. The Basis for Conclusions acknowledged that there have been differing views about the appropriateness of a risk adjustment in the context of social benefits.

Although entities applying NZ IFRS 4 *Insurance Contracts* and PBE IFRS 4 *Insurance Contracts* have applied a risk margin[2] as required by those standards, there has been debate about whether this is appropriate, particularly when the determination of future contributions is based on figures that exclude the risk margin.

The AASB has also considered this issue in Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities* (November 2017). The AASB has proposed to include some additional guidance on determining the risk adjustment factor for non-financial risk (see extract below). The AASB concludes that although the risk adjustment might differ from a for-profit private sector entity, it is unlikely to be nil (see extracts from the AASB's Basis for Conclusions below). The AASB has sought feedback on whether there might ever be a risk adjustment factor of zero. We encourage the IPSASB to liaise with the AASB about the responses it receives on this matter.

Extract from AASB DP (November 2017)

Risk adjustment for non-financial risk

E18 Paragraph 37 of this Standard requires an entity to incorporate a risk adjustment in the measurement of insurance contracts. A public sector entity shall include a risk adjustment when measuring rights and obligations arising from insurance-like arrangements.

E19 The risk adjustment shall reflect the amount that the public sector entity requires for bearing uncertainty about the amount and timing of the cash flows that arises from non-financial risk related to insurance-like arrangements. As for issuers of insurance contracts, a public sector entity will reflect the degree of diversification arising from insurance-like arrangements and the public sector entity's risk aversion (risk appetite).

E20 A public sector entity shall consider the extent of diversification in its portfolio, the entity's risk appetite and required return on capital in determining this amount in the same was as private sector issuers of insurance contracts.

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2 Those standards refer to a risk margin although IFRS 17 refers to a risk adjustment. Prior to IFRS 17, the insurance accounting standards in Australia and New Zealand require an explicit risk margin in determining outstanding claims liabilities. The standards do not prescribe a fixed margin or the level of adequacy required, but state that risk margins adopted for regulatory purposes may be appropriate for the purposes of the standard, or as a starting point in determining such margins. Insurers must however disclose the probability of adequacy intended to be achieved by their adopted margin. For public sector entities in New Zealand this is typically expressed as "a risk margin to ensure the accrued liability is sufficient to meet all the costs of future claim payments 75% of the time."

….

BC9 In relation to risk adjustments, the Board acknowledges that public sector entities can take a view extending beyond current insurance arrangements and, over the long-term, the best estimate liability is the appropriate total amount to recognise. That is, there is no need for a risk adjustment. This view is often supported on the basis that:

(a) public sector insurers usually have the benefit of a government guarantee underpinned by taxing powers, which could potentially be called upon for support and sustain them in bad times; and/or

(b) some public sector entities enjoy monopoly status and have the power to recover cost overruns in any given period by increasing premiums or levies in following years.

BC10 In relation to the support that might be applied by government to a particular entity, the Board considers the uncertainties associated with outstanding claims cash flows in respect of past transactions, that would be reflected in a risk adjustment, to be a characteristic of the claims liability. In relation to the impact of an entity's monopoly status, the Board considers that, in respect of the current (usually annual coverage) transactions, the entity is bearing risk for that period. Any potential to pass that risk back to external parties relates to possible future transactions that are not the subject of financial reporting for the current period. Accordingly, the risk adjustment might differ from a for-profit private sector entity, however, is unlikely to be nil.

BC11 AASB 17 appendix A defines 'risk adjustment' as "the compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract".

BC12 AASB 17 paragraph B88 comments that:

"Because the measurement of the risk adjustment reflects the compensation that the entity would require for bearing the non-financial risk arising from uncertain amounts and timing of the cash flows, the risk adjustment for non-financial risk also reflects:

(a) the degree of diversification benefit that the entity considers when determining the compensation it requires for bearing that risk; and

(b) both favourable and unfavourable outcomes in a way that reflects the entity's degree of risk aversion."

BC13 The Board notes that public sector entities with the benefit of a government guarantee supported by taxing powers and which may also have the benefit of monopoly status might have a less risk averse approach to its activities than entities without these characteristics. Consequently, public sector entities may have a different risk adjustment to an equivalent private sector entity which did not have such characteristics.

We can understand the IPSASB's reasons for not wanting to establish alternative requirements to those in IFRS 17, as this would take time and resources. However, we think the IPSASB does need to form a view about whether public sector entities should be required to include a risk adjustment and the matters entities should consider in determining that risk adjustment. This might be done by developing guidance or sharing information about the ways in which various public sector entities have approached this issue. We note that similar issues are likely to be encountered when IFRS 17 is incorporated into the UK Financial Reporting Manual. There may also be an opportunity to build on any material developed to assist private sector entities applying IFRS 17 as surveys have indicated that the determination of the risk adjustment is a key area of uncertainty for such entities. Regardless of how the IPSASB chooses to provide guidance, we think that it is an area that requires attention.

We note that the words "by analogy" have been used throughout the standard. We assume that this is because the IPSASB is of the view that the liabilities arising from social benefit schemes would not fall within the scope of IFRS 17 and that the requirements in IFRS 17 would be applied to such obligations "as if they were insurance contracts". We think it would be helpful for the BC to explain why the IPSASB has used the words "by analogy".

As we already have an insurance standard for public sector and not-for-profit entities in New Zealand, and are considering whether or not to develop an equivalent of IFRS 17 for such entities, we would need to carefully consider the scope of any social benefit standard and the IFRS 17 equivalent, and the transitional arrangements. We make this point not because we expect the IPSASB to consider the circumstances of each jurisdiction, but because this might be a more widespread issue. Jurisdictions looking to pick up the insurance approach in ED 63 for social benefits would need to consider how entities in that jurisdiction have previously been accounting for such social benefits and develop appropriate transition requirements. In the absence of an IPSAS on insurance contracts practice is likely to vary.

<u>Response to SMC3(d)</u>

SMC3(d) Do you agree that, with respect to the insurance approach, the additional disclosures required by paragraph 12 of this Exposure Draft are appropriate?

We agree that the additional disclosures required by paragraph 12 are appropriate. Paragraph 12(a) is fairly clear that it requires a summary of the key features of the social benefit scheme as it also requires that the entity explain how additional information about the scheme can be obtained. Paragraph 12(b) which requires disclosure of significant amendments to the scheme during the reporting period also seems to have a high-level focus.

We agree that the standard should require disclosure of summary information about benefits and changes to them. However, in the case of schemes which manage many different benefits we wonder if this information needs to be included in the financial statements or could be provided elsewhere. If such information is readily available in other reports we think the standard could permit cross referencing to such other documents. This could be in relation to the information required by paragraph 12, but it could also be in relation to other disclosure requirements.

Specific Matter for Comment 4:
Do you agree that, under the obligating event approach, the past event that gives rise to a liability for a social benefit scheme is the satisfaction by the beneficiary of all eligibility criteria for the next benefit, which includes being alive (whether this is explicitly stated or implicit in the scheme provisions)?
If not, what past event should give rise to a liability for a social benefit?
This Exposure Draft includes an Alternative View where some IPSASB Members propose a different approach to recognition and measurement.

<u>Response to SMC4</u>

We support the *outcome* of how the IPSASB has applied the obligating event approach to social benefit schemes that are intended to be funded through future taxes, but do not agree with the *rationale* provided by the IPSASB for the proposals in ED64 (including disagreeing with the IPSASB's views on 'being alive'). We support the outcome on the grounds that the recognition of large liabilities for social benefits, without the recognition of future cash flows that will fund those benefits, is unlikely to result in financial statements that meet the objectives of general purpose financial reporting and satisfy the qualitative characteristics. However, we disagree with the rationale provided and aspects of the obligating event approach in the ED, and therefore propose some changes.

More specifically, we do not support the way in which the IPSASB has set up the proposed liability recognition requirements for the obligating event approach in ED 63. Determining the relevant past event for a particular social benefit obligation and the existence of a present obligation that meets the definition of a liability and recognition criteria in the Conceptual Framework is difficult and involves significant judgement. This is evidenced by the IPSASB's discussions over many years and the fact that ED 63 includes an Alternative View. We think that ED 63 makes unnecessary assertions about the past event – they are unnecessary in the sense that the IPSASB could establish standards-level recognition and measurement requirements without making such sweeping assertions.

To explain the above points, we set out below our consideration of the identified past event (including the alternative view) and then propose a way forward.

What is the relevant past event and what are the implications?

We acknowledge that getting agreement about the relevant past event and the corresponding implications of basing the recognition and measurement of liabilities for social benefits on that event is difficult. The NZASB has had a number of discussions over the last few years about the point at which the New Zealand Government has, or might have, a present obligation for particular types of social benefits. There are some benefits where we could easily agree that the recognition of a liability for the next benefit payment only is appropriate. There are other benefits such as New Zealand Superannuation (a benefit paid to most citizens over 65 years and which is not means tested) where we have had a range of views, including those expressed in the Alternative View about the possibility of key participatory events giving rise to a liability. Some would argue that upon reaching the age of 65 and satisfying the other eligibility criteria, most citizens will have a valid expectation that they will receive National Superannuation payments for the rest of their lives, not just the next payment. Although governments can and do change entitlements to old age benefits, in New Zealand this has generally been by raising the age of entitlement or lowering benefits for future recipients – not by changing entitlements to those that have already met the threshold eligibility criteria. We are also aware that the nature of a government's promise to potential recipients and the strength of the recipients' expectations is likely to differ between types of benefits and between jurisdictions.

These discussions have led us to think hard about what it is most useful to report in general purpose financial statements, whether there are conceptual arguments to support the obligating event approach in ED 63 and whether it is conceptually consistent to support the obligating event approach for certain benefits and the insurance approach for others.

Going back to concepts

Our overall view is that to meet the objectives of general purpose financial reporting in accordance with the qualitative characteristics and pervasive constraints discussed in the Conceptual Framework, it is necessary to consider how obligations for future benefits are managed. In the case of schemes which are managed in the same way as an insurer would manage its insurance contracts and which are substantially fully funded, we consider that it is appropriate to report both the assets and liabilities associated with that activity. In the case of other benefits which are not managed in this way and which are to be funded through future taxes, the recognition of large liabilities for social benefits, without the recognition of future cash flows that will fund those benefits, is unlikely to result in financial statements that meet the objectives of general purpose financial reporting and satisfy the qualitative characteristics.

We have thought about how this view can be reconciled with the Conceptual Framework, bearing in mind that the parts of the Conceptual Framework which deal with the definition of a liability and the recognition of liabilities do not discuss an entity's business model or sources of funding.

The topic of social benefits calls into question the boundary between what should be included in financial statements and what should be included in long-term fiscal sustainability reports. Generally we think the definitions of assets and liabilities and the recognition criteria serve us well in drawing appropriate boundaries around what is recognised in financial statements. In the case of social benefit liabilities we think that it is necessary to go back to the qualitative characteristics. The difficulty that we have encountered is that Chapter 3 of the Conceptual Framework is written with general purpose financial reports (not just financial statements) in mind. We consider that the focus of Chapter 3 of the Conceptual Framework is appropriate, but it does not help us in considering the application of the qualitative characteristics to these two different forms of reporting.

Relevance and understandability are the two qualitative characteristics that we think would be most pertinent to the consideration of whether information is most usefully reported in financial statements or long-term fiscal sustainability reports. We acknowledge that the relevance and understandability of information is influenced by users' education, experience and expectations and that it is difficult to draw conclusions about user needs when there are diverse groups of users. We do not consider that the recognition of all social benefit liabilities in financial statements would meet the needs of users of financial statements.

As noted in the UK *Fiscal Sustainability Report* (January 2017), in analysing the stocks and flows of a government, there is a trade-off between completeness and certainty. To quote from that report: "Balance sheets provide reasonably reliable estimates of assets and liabilities related to past activity (though even here there are a number of difficulties with estimation and data availability). But they are incomplete, as they do not account for many elements of future activity. Long-term projections paint a fuller picture, but are extremely uncertain."

In our view social benefit liabilities sit on the cusp of the dividing line between completeness and certainty. Without information on social benefit obligations it could be argued that the financial statements are incomplete. But it could also be argued that, even if liabilities for social benefit obligations were to be included, they would still be incomplete in the sense that information about future taxes would not be included. The existence and amount of potential long-term social benefit liabilities would also be subject to considerable uncertainty.

The Alternative View and being alive

Although we support much of the discussion in the Alternative View, we think that it would be difficult to operationalise this view into an international standard. Even if one accepts the possibility of key participatory events giving rise to a liability for all future benefits, this is likely to be the case for certain benefits in certain jurisdictions only. It is also likely that there would be differing views within a jurisdiction about which benefits a liability should be recognised for. In addition, we do not think the Alternative View has gone far enough. It has not considered whether the recognition of very large liabilities would be consistent with the objectives of general purpose financial reporting, the role of financial statements and the application of the qualitative characteristics.

The Alternative View (paragraphs AV16 to AV21) has also been helpful in prompting discussion about whether, in cases where an entity has a present binding obligation in respect of future social benefits, "being alive" is relevant to measurement rather than relevant to the recognition of the liability. We concur with the comments in paragraph AV18 that, *taking a population as a whole*, measurement of long-term liabilities is possible and we note that actuarial assessments are already used to support the measurement of a number of long-term liabilities.

However, it is possible to argue that being alive is not, in itself, a specific eligibility criterion and is not, therefore, relevant to determining the recognition point.

Generally, being alive is necessary, but not sufficient, for determining eligibility. Although being alive may be inseparable from the specified eligibility criteria (for example, in the case of an old age pension that starts at age 65, the individual cannot get the pension unless he or she is alive at age 65), the purpose of each type of benefit to individuals is to support people in particular circumstances (for example, an old age pension supports people after a certain age and an unemployment benefit supports people that are unemployed). Being alive applies in all these cases, so it is not part of the specific eligibility criteria for any particular benefit.

Having met the specific eligibility criteria for a particular benefit, staying alive does impact on how long the individual continues to receive that benefit, so it does become part of measurement of the benefit payable to eligible individuals. We would therefore prefer that the obligating event approach focus on the nature of the promise, the eligibility criteria for that benefit, and the ongoing requirements for revalidation, rather than relying on being alive as an eligibility criterion. In this regard, we also note that benefits may sometimes be paid to the estate of a deceased person, so being alive is not always necessary to be eligible to receive a particular type of benefit.

We suggest that, rather than focusing solely on the definitions of elements and the recognition criteria, the IPSASB should focus on where users would find information on social benefit liabilities most useful. We think that the characteristics of some large social benefit liabilities means that information on them would be more useful in the context of long-term projections where the implications of continuing current social benefit policies can be considered along with all other projected spending and the options for dealing with the inevitable fiscal challenges. In responding to SMC6 we have noted the usefulness of long-term fiscal sustainability reporting for providing a more complete picture of a government's projected inflows and outflows over a longer-term horizon.

Way forward

We disagree with the way in which the IPSASB has set up the proposed liability recognition requirements for the obligating event approach in ED 63. We think that some paragraphs, such as paragraphs 16 and 20, go further than they need to and invite unnecessary arguments. We think that the body of the standard should be limited to identifying the recognition requirements, and that this could be achieved without making assertions about the past event. This could be done is by omitting paragraphs 13 to 16 and redrafting paragraphs 17 and 18 to deal with the recognition of both a liability and an expense. We think that the Basis for Conclusions is the appropriate place for the IPSASB to explain all of the arguments that it considered in developing the standards-level requirements.

The arguments used to support the proposed obligating event approach (paragraphs 16 and 20) and the arguments in the Alternative View have been established as competing views. This has been useful for prompting debate on the exposure draft, but we would encourage the IPSASB to think about how it can draw on both views in finalising a standard and explaining its conclusions. We suggest that the IPSASB develop a rationale for the obligating event approach based on the objectives of general purpose financial reporting and the qualitative characteristics.

Specific Matter for Comment 5:
Regarding the disclosure requirements for the obligating event approach, do you agree that:
(a) The disclosures about the characteristics of an entity’s social benefit schemes (paragraph 31) are appropriate;
(b) The disclosures of the amounts in the financial statements (paragraphs 32–33) are appropriate; and
(c) For the future cash flows related to an entity’s social benefit schemes (see paragraph 34):
  (i) It is appropriate to disclose the projected future cash flows; and
  (ii) Five years is the appropriate period over which to disclose those future cash flows.
If not, what disclosure requirements should be included?

Response to SMC5(a)

Regarding the disclosure requirements for the obligating event approach, do you agree that the disclosures about the characteristics of an entity’s social benefit schemes (paragraph 31) are appropriate?

We have received feedback from our constituents that disclosure of information on how the scheme is funded is important for users to understand the sustainability of such schemes. We note that the IPSASB has included a requirement to disclose information about how the scheme is funded in paragraph 31(a)(iii) and we agree with this requirement.

We acknowledge that the remainder of the information required to be disclosed by paragraph 31 would be useful to readers of the financial statements. However, we do have concerns that it would add considerable length to the financial statements. We would be concerned that this increased length could obscure other useful information. We would like the IPSASB to consider whether the financial statements are the most appropriate place for this information.

A better option might be to allow cross-referencing to other documents or sources of information. We note that paragraph 31(a)(ii) requires a statement about how additional information about the scheme can be obtained and paragraph 31(a)(iii) a permits a cross-reference to the location of information on social contributions. We suggest that the IPSASB allow the more general use of cross-referencing in meeting the disclosure requirements of the proposed standard. There would also need to be some requirements regarding the use of cross-referencing.

We note that the NZASB has recently issued a domestic standard on reporting service performance information. An extract from PBE FRS 48 *Service Performance Reporting* in relation to the use of cross-referencing is shown below.

Extract from PBE FRS 48 *Service Performance Reporting*

32. An entity may cross-reference the service performance information and the financial statements so that users can assess the service performance information within the context of the financial statements.

33. In presenting service performance information in accordance with this Standard an entity may incorporate, by cross-reference, information outside the general purpose financial report. The use of cross-referencing is permitted subject to the following requirements.
    (a) It is still possible to identify the complete set of service performance information presented in accordance with this Standard.
    (b) Locating the information elsewhere enhances the understandability of the general purpose financial report as a whole and the service performance information remains understandable and fairly presented.
    (c) The cross-referenced information is available to users of the service performance information on the same terms as the general purpose financial report and at the same time.

34. Incorporating service performance information by cross-reference enhances the understandability of the service performance information if it:
    (a) Links related information together so that the relationships between items of information are clear; and/or
    (b) Reduces duplication of information.

35. If an entity applies cross-referencing in accordance with paragraph 33, it shall:
    (a) Disclose, together with the statement of compliance in accordance with paragraph 28 of PBE IPSAS 1 *Presentation of Financial Reports*, a list of cross-referenced information that forms part of a complete set of service performance information in accordance with this Standard;
    (b) Depict cross-referenced information as being information prepared in accordance with this Standard (and audited if applicable);
    (c) Make the cross-referencing direct and precise as to what it relates to; and
    (d) Ensure cross-referenced information remains unchanged and available over time at the cross-referenced location.

We have considered the discussion in ED 63's Basis for Conclusions on whether the IPSASB should provide guidance on aggregating the disclosures for social benefit schemes that are not individually material. In developing ED 63 the IPSASB noted that IPSAS 1 *Presentation of Financial Statements* contains guidance on materiality and aggregation and concluded that no further guidance was required. Materiality is well-established as a concept in relation to recognition and measurement, but is less well-established in relation to disclosure. We believe that this signals a need for specific guidance on making judgements on materiality in relation to disclosures.

We note that the illustrative examples in ED 63 are for the reconciliation required by paragraph 33 and expected cash outflows required by paragraph 34. ED 63 does not have an illustrative example on the characteristics of social benefit schemes. Such an example could be used to provide guidance on materiality and aggregation.

Response to SMC5(b)

Regarding the disclosure requirements for the obligating event approach, do you agree that the disclosures of the amounts in the financial statements (paragraphs 32–33) are appropriate?

We note that these disclosures are in respect of the obligating event approach (which limits the liability to the point at which the social benefit will NEXT be provided). Under the proposed obligating event approach in the ED these liabilities will be constrained. Entities will have to consider materiality in deciding whether they have to make these disclosures. Even if an entity decides it does not have to make the disclosures or can aggregate disclosures, it will still incur costs in making that assessment.

We do not agree that the an entity should provide a reconciliation from the opening balance to the closing balance of the liability for each social benefit scheme (paragraph 33). Given that users can get most of this information from an analysis of the financial statements, we do not think that the benefit of the reconciliation outweighs the cost of preparation.

Response to SMC5(c)

Regarding the disclosure requirements for the obligating event approach, do you agree that for the future cash flows related to an entity's social benefit schemes (see paragraph 34):

(i) It is appropriate to disclose the projected future cash flows; and

(ii) Five years is the appropriate period over which to disclose those future cash flows?

If not, what disclosure requirements should be included?

Although this SMC refers to "future cash flows", paragraph 34 requires an entity to disclose its best estimate of cash ***outflows*** for a period of five years. We disagree that, taken in isolation, the provision of cash outflows provides useful information for users. This is because it will be difficult for users to make assessments of matters such as liquidity and sustainability without information on the bigger picture. Projections of outflows are best considered together with projections of inflows and are most useful when they are comprehensive, rather than focusing on a single social benefit scheme. In most cases, it would not be possible to project cash inflows for a single social benefit scheme as the majority of these schemes will be funded from the general tax take.

In making the above points, we noted the arguments considered by the IPSASB in deciding to require an entity to disclose its best estimate of projected cash outflows, as set out in paragraphs BC97 to BC100. In light of the IPSASB's objective for these disclosures, we reiterate our comments made in SMC 4 and SMC 6 on the importance of long-term fiscal sustainability reporting for providing a more complete picture of a government's projected inflows and outflows over a longer-term horizon. In the case of governments that already publish long-term fiscal information, or individual entities that already publish long-term information about particular schemes, we would like the IPSASB to require that entities refer, in their financial statements, to such reports. We are not, however, suggesting that long-term fiscal sustainability information be presented as an integral part of the financial statements.

We acknowledge that early adopters of IPSAS Standards and accrual accounting are likely to require some time before they are in a position to produce a long-term fiscal sustainability report. From our own experience in New Zealand there was a significant time lag between the adoption of accrual accounting and the issue of the first long-term fiscal sustainability report at a whole-of-government level.

We would like the IPSASB to do some more thinking about the objectives of the additional disclosures in ED 63, and the most cost-effective way of achieving those objectives for jurisdictions which are not currently in a position to produce long-term fiscal sustainability reports.

We recognise that identifying a suitable alternative is not an easy task. Nevertheless, we remain unconvinced that disclosure of five-year cash outflows will meet the stated objectives of this disclosure.

Other comments

If such disclosures were to be required, we think that the standard would need to consider how to deal with the duplication of information in whole-of-government consolidated reports. Would both the entity administering the scheme and the whole of government be required to present the disclosures or would there be the possibility of cross-referencing information already available in another report? These considerations are particularly important given the recent focus on trying to limit the length of financial statements and keep disclosures understandable and accessible.

Constituent outreach in New Zealand highlighted that government spending is often presented as a percentage of GDP. The presentation of spending as a share of total public expenditures or per capita is also used to compare spending between countries and over time. We therefore considered whether it would be appropriate for an IPSAS to permit or mandate disclosure of future cash flows as a percentage of GDP or total spending. In our view the IPSASB should not preclude such presentation but nor should it mandate a particular form of presentation. Some readers may prefer to see spending displayed in the relevant currency. In any case, if percentages or per capita figures are used, readers should always be able to access the underlying figures.

Specific Matter for Comment 6:

The IPSASB has previously acknowledged in its Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities, that the financial statements cannot satisfy all users' information needs on social benefits, and that further information about the long-term fiscal sustainability of these schemes is required. RPG 1, *Reporting on the Long-Term Sustainability of an Entity's Finances*, was developed to provide guidance on presenting this additional information.

In finalizing ED 63, the IPSASB discussed the merits of developing mandatory requirements for reporting on the long-term financial sustainability of an entity's finances, which includes social benefits. The IPSASB identified the following advantages and disadvantages of developing such requirements at present:

Advantages	**Disadvantages**
Long-term financial sustainability reports provide additional useful information for users for both accountability and decision making, and that governments should therefore be providing. This especially applies to information about the sustainability of the funding of social benefits given the limited predictive value of the amounts recognized in the financial statements.	The extent and nature of an entity's long-term financial reports are likely to vary significantly depending on its activities and sources of funding. It would therefore be difficult to develop a mandatory standard.
Social benefits are only one source of future outflows. Supplementary disclosures (as proposed in the ED) on social benefits flows in isolation are therefore of limited use in assessing an entity's long-term sustainability, as they do not include the complete information on all of an entity's future inflows and outflows that long-term financial sustainability reports provide.	The nature of the information required for reporting on the long-term sustainability of an entity's finances, in particular, its forward-looking perspective, could preclude its inclusion in General Purpose Financial Statements. Given the scope and challenges involved in its preparation and audit considerations, some question whether it would be appropriate to make information in a General Purpose Financial Report mandatory.
Long-term financial sustainability reports will improve accountability and will help support Integrated Reporting <IR> in the public sector. They will also provide useful information for users, in particular for evaluations of intergenerational equity.	RPG 1 was only issued in 2013, so it may be too soon to assess whether requirements developed from those in RPG 1 should be mandatory.

Do you think the IPSASB should undertake further work on reporting on long-term fiscal sustainability, and if so, how?

If you think the IPSASB should undertake further work on reporting on long-term fiscal sustainability, what additional new developments or perspectives, if any, have emerged in your environment which you believe would be relevant to the IPSASB's assessment of what work is required?

On balance, our view is that long-term fiscal reporting should continue to be optional. We agree that the IPSASB has identified the main arguments for and against developing mandatory reporting requirements on long-term fiscal sustainability and consider that the points identified as disadvantages of mandatory long-term reporting are so important that they should be given more weight than the points identified as advantages of mandatory long-term reporting. We comment further on some of these points later in this response.

In SMC4 we disagreed with the arguments used by the IPSASB to justify its obligating event approach proposals (although we agreed that the resulting accounting might be appropriate) and stressed the role of long-term fiscal sustainability reports in providing information about long-term future outflows and inflows. The advantages of long-term reports are that they provide information about outflows for current and future beneficiaries and they allow future outflows to be considered alongside future inflows from taxes. Long-term fiscal sustainability reports encourage jurisdictions to consider long-term fiscal challenges and the options for dealing with those challenges. It informs governments and constituents about how current policies will affect a government's future financial position. For all these reasons we support the provision of comprehensive information in long-term fiscal reports.

The importance of long-term information has been acknowledged in New Zealand with a legislative requirement to prepare such reports. The Public Finance Act 1989 (section 26N) requires that, at least every four years, the New Zealand Treasury publish a statement on the long-term position of the Government for the next 40 years. The most recent such report, *He Tirohanga Mokopuna: 2016 Statement on New Zealand's Long-term Fiscal Position*, was published in November 2016.

Although we acknowledge the importance of long-term information, we do not think that it would be appropriate for the IPSASB to develop mandatory standards-level requirements at this time. In addition to the arguments identified by the IPSASB we note the following.

(a) For governments looking to adopt accrual IPSAS Standards, additional requirements could be regarded as a disincentive to adoption.

(b) Jurisdictional differences, including legislative reporting requirements, would make it difficult to establish mandatory requirements. Legislative differences would mean that any standard would need to have an even higher-level focus than RPG 1.

(c) This field of reporting is continuing to evolve and it would be difficult to establish mandatory requirements in such an environment. The 2017 OECD report *Rationalising Government Fiscal Reporting – Lessons learned from Australia, Canada, France and the United Kingdom on how to better address users' needs* shows that fiscal reporting, of which long term sustainability reporting forms a part, is continuing to evolve and outlines developments in those jurisdictions. This evolution is also occurring in New Zealand. The November 2016 projections not only identified long-term fiscal challenges and some of the options for managing those pressures, it also considered how improving social outcomes might provide fiscal benefits and improve living standards.

SMC6 asks what further work the IPSASB should undertake in this area. We have two suggestions.

(a) Although an increasing number of countries are now producing long-term fiscal sustainability reports, we have not identified any that assert compliance with RPG 1. The IPSASB could investigate the main reasons for this. For example, do jurisdictions consider that such assertions are not necessary, or are there conflicts between RPG 1 and legislative requirements?

(b) We think that the IPSASB has a role to play in continuing to emphasise the importance of reports on long-term fiscal sustainability and stressing the importance of good financial reporting as a precursor to good long-term reporting. As per our response to SMC 5(c), we suggest that the IPSASB require that entities refer, in their financial statements, to any published long-term fiscal sustainability reports.

Other comments

First-time Adoption

ED 63 proposes to give a three-year relief period for the recognition and/or measurement of social benefits for first-time adopters. Although we understand that one of the roles of IPSAS 33 *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* is to encourage the adoption of IPSAS Standards, we do not agree with granting a three-year exemption from application of the standard.

Our reasons for disagreeing with this proposal are as follows.

(a) We are not supportive of three-year exemptions in general.

(b) Social benefits are a fundamental aspect of a government's activities. If a government cannot report on its social benefits in accordance with ED 63, we think that it should delay the adoption of IPSAS until it is in a position to do so.

(c) An entity should have the information required to report in accordance with the obligating event proposals in ED 63 (although we have commented on compliance costs associated with the proposed disclosures).

(d) An entity that is already managing a scheme as an insurance scheme and that intends to apply insurance accounting should have good information about its liabilities.

Editorial comments

We have identified some editorial matters for consideration if the paragraphs identified are carried forward into the final standard.

Paragraph	Comment
13	(b) … and takes account of the <u>pervasive</u> constraints on information in general purpose financial reports. Although paragraph 13(b) is consistent with the wording in paragraph 6.2 of the Conceptual Framework, anyone reading paragraph 6.2 in the Conceptual Framework will be aware that the constraints are referred to as pervasive constraints. Reading this statement in a different context readers may not get this message. We therefore suggest adding the word pervasive.
30 and 34	Paragraph 30 refers to future cash flows that "may" arise from an entity's social benefit schemes and refers to paragraph 34. Paragraph 34 refers to projected cash flows that "will" arise from a scheme.
	Amendments to other IPSAS Standards
IPSAS 19	Paragraph 1 lists scope exclusions. ED 63 is proposing to replace the current social benefit exclusion in paragraph 1(a) with the words "Social benefits within the scope of [draft] IPSAS [X] (ED 63). Because IPSAS 19 paragraph 1(e) already excludes provisions, contingent liabilities and contingent assets "covered by another IPSAS" we do not think that the proposed exclusion in paragraph 1(a) is required. However, ED 63 is not proposing to deal with all of the social benefits that are currently excluded from the scope of IPSAS 19. As noted in our response on SMC1 there may still need to be a scope exclusion for those social benefits that are currently excluded from the scope of IPSAS 19 but which are not being addressed in ED 63.
IPSAS 19	We think paragraph 111G should be paragraph 111H.
IPSAS 28	We think paragraph 60E should be paragraph 60F.
IPSAS 33	We think paragraph 157 should be paragraph 158 (if paragraphs are numbered sequentially from paragraph 154).
	Illustrative Examples
IE26–IE31	*Example 8* Paragraph IE26 states that the pensions are paid at the end of each month. It isn't clear from the example whether (i) there is a benefit payment at the end of December and the accrual relates to the benefits to be paid at the end of January or (ii) December benefits are paid early in January.
IE32–IE41	*Example 9* Paragraph IE34 states that the pensions are paid at the end of each month. It would be helpful if the example clarified whether there is a benefit payment at the end of December, or whether the December benefits are paid in early January.
IE42–IE52	*Example 10* Paragraph IE42 "unemployment pension" should read "unemployment benefit''. We think (from reading paragraph IE46) that the amounts paid on the 15^{th} of each month relate to the month ending on the 15^{th}, but it would be helpful if the example made this clear.

NZ ACCOUNTING STANDARDS BOARD

12 January 2018

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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 was exposed for comment 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 of which are important topics in the public sector and in our not-for-profit (NFP) sector which also applies IPSAS-based standards.

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 adequately addressed a number of key issues.

The limited comment period and broad scope of the CP has meant that the NZASB has had to focus its comments on what it considers to be the most significant issues. Our comments focus on the proposed recognition approaches for revenue and non-exchange expenses. With respect to these issues, we have invested a considerable amount of resources and sought wider constituent feedback. Because of this, some of our responses on other matters are at a high level only. We would have preferred a comment period greater than five months so that we could have fully considered all the issues in the CP.

Our main comments are summarised below and are elaborated upon in Appendices 1 and 2. We would be happy to meet with you to discuss these comments further.

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 and without performance obligations,[1] 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) as proposed in the CP, 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 revenue standard). This residual standard would be based on the applicable parts of IPSAS 23 *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, updated to address issues relating to these types of transactions.
- We do not agree with the CP's proposal to apply the PSPOA to revenue transactions with no performance obligations but with stipulations over use (including consumption based[2] and time-based stipulations). In our view, such unfulfilled stipulations do not give rise to a liability as defined in the Conceptual Framework (i.e. they do not require an outflow of resources to an external party) – the only "obligation" is for the entity to use the funds to acquire resources for itself, rather than to transfer goods or services to other parties. In other words, although the stipulations might be regarded as "obligations" in a broader sense, they are not the type of obligation referred to in the definition of a liability.[3] Instead the revenue from these 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 which could highlight the existence of stipulations over the use of resources received and the timing of fulfilment of those stipulations. These options could help to resolve the problem of explaining the resource recipient's performance story, while also faithfully representing the resource recipient's financial position.

  We consider that this approach is consistent with the definitions of elements in the Conceptual Framework.

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1 For the purpose of our proposed recognition framework, the NZASB considers that a revenue or expense transaction with performance obligations is one that involves an enforceable agreement between the resource provider and the resource recipient requiring the resource recipient to deliver goods or services either to the resource provider or to beneficiaries.

2 Consumption-based stipulations arise when the resource provider agrees to transfer resources to the resource recipient with the stipulation that the resource recipient must use the resources as specified for its own operations, without imposing on the resource recipient an obligation for an outflow of resources to another party.

3 The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (Conceptual Framework), paragraph 5.14, defines a liability as "a present obligation of the entity for an outflow of resources that results from a past event".

- A significant amount of work is still required by the IPSASB to consider a number of revenue transactions not covered in the CP such as revenue transactions without performance obligations, but with other forms of stipulations over use.

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, the analysis of those transactions discussed in the CP is insufficient, both in terms of the rationale provided and the consideration of alternative views.
- The CP's inadequate analysis of non-exchange expenses has compelled us to do a lot of thinking about the range of expenses in the public sector and the appropriate recognition approaches for various types of expenses. Similar to our proposed framework for the recognition of revenue, our proposed framework for the recognition of expenses is also based on a distinction between transactions that impose performance obligations on the resource recipient and those that do not.
- We do not agree with the discussion of universally accessible services and collective services in the CP. We consider that there are no significant conceptual differences between the types of transactions that would fall within the scope of Exposure Draft 63 *Social Benefits* and universally accessible services and collective services. In our opinion, the accounting for these expenses would require consideration of similar issues and should be consistent. 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, which we refer to as 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 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 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 two options are outlined in our detailed response. Whilst we have proposed the same options as for revenue transactions, we note that the rationale for applying either of these options to expense transactions is not necessarily the same.

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 responses 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

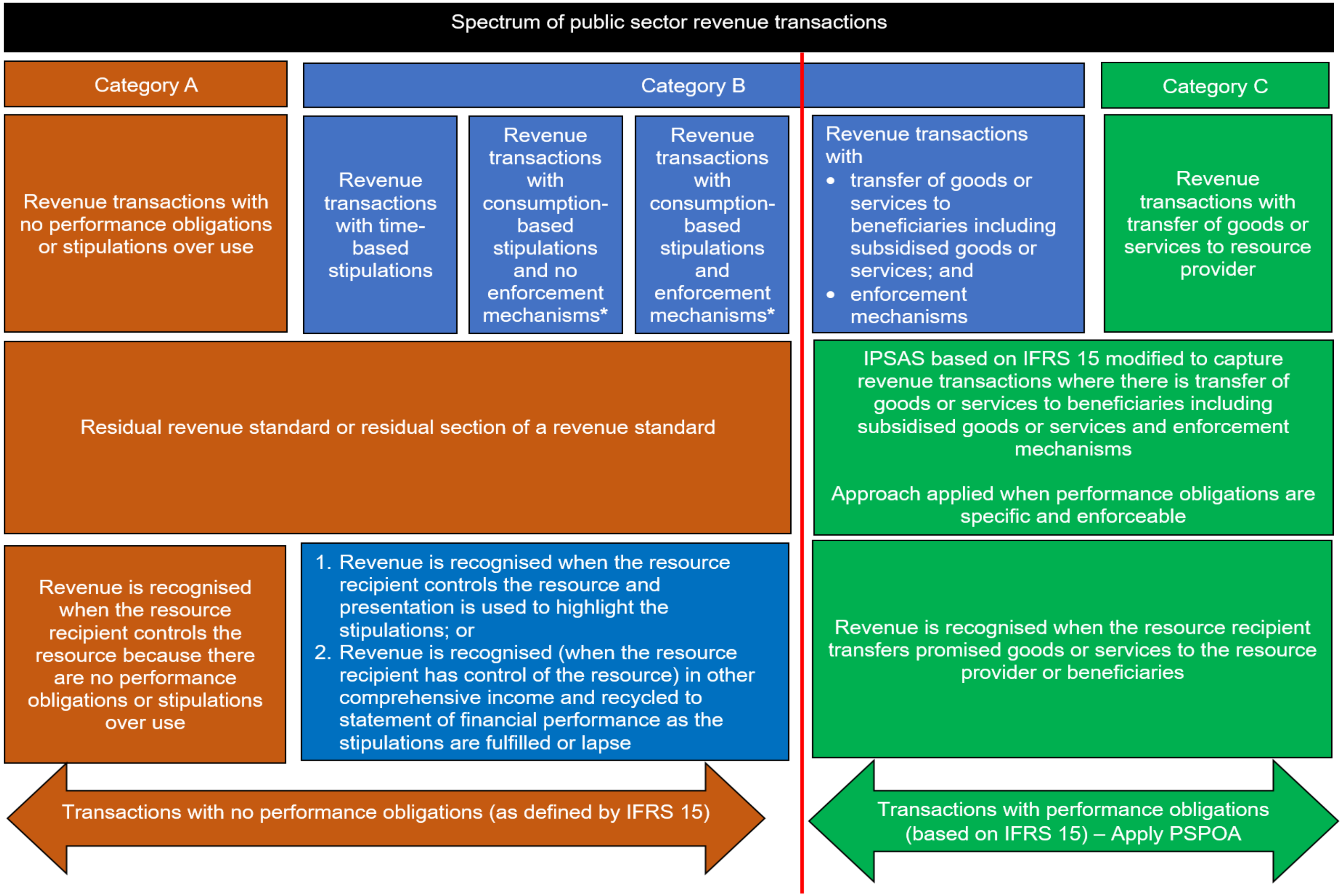
The New Zealand Accounting Standards Board (NZASB) has considered the proposed revenue recognition approaches in the Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (the CP) and is of the view that these proposals do not fully capture all the revenue transactions that can occur in the public sector, nor do they address all the revenue issues identified in the CP. The CP focuses on revenue transactions with performance obligations, and 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,[4] 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 and 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.

4 Consumption-based stipulations arise when the resource provider agrees to transfer resources with the stipulation that the resource recipient must use the resources as specified for its own operations, without imposing on the resource recipient an obligation for an outflow of resources to another party.

Diagram 1 NZASB's proposed framework for revenue recognition



* These categories include capital grants.

The CP has grouped revenue transactions into three categories (Categories A, B, and C) and used these three categories 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 concept of a "performance obligation" in IFRS 15 *Revenue from Contracts with Customers* is stretched to reflect the public sector context.

For revenue transactions with performance obligations (i.e. that is an enforceable agreement to deliver goods or services to an external party), our proposed framework is based on the Public Sector Performance Obligation Approach (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 for General Purpose Financial Reporting by Public Sector Entities* (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 and 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 *Revenue from Non-Exchange Transactions (Taxes and Transfers)* and updated to address practice issues relating to these types of transactions. These matters are discussed further in our responses to PV 2 and SMC 1.

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 (as explained further below). Hence, our proposed framework would remove the current distinction between conditions and restrictions as such a distinction would not be relevant, and in our view, 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. We elaborate further on this point below.

<u>Transactions currently within the scope of 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.

- Enforcement mechanisms

  We agree with the CP's view that the concept of enforceability in a binding arrangement would need to go beyond the existence of a return obligation and include other enforcement mechanisms where the transferor has access to 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 have other enforcement mechanisms, 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

  One interpretation of the definition of exchange and non-exchange transactions in the current IPSAS literature 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. Those who take this view argue that 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 directly 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

  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 on a cost-recovery basis should be accounted for under the PSPOA.

<u>Other issues for consideration</u>

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

<u>Transactions with consumption-based stipulations and enforcement mechanisms</u>

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 in our view a liability does not exist.

Our thinking can be explained using an example whereby a medical practice receives funding for the salary of its office manager. The office manager carries out administrative duties and provides support services to the medical practice. The office manager is therefore only indirectly involved in the provision of the health services to the patients. The funding of the office manager's salary does not impose an obligation on the entity to transfer resources to an external party, so in our view a liability does not exist. Rather, the stipulation on how the resources must be used requires the resource recipient (the medical practice) 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 which is not subject to 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. 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, which we do not believe is appropriate.

We also considered an argument based on "substance over form" and principal versus agent considerations. It could be argued that, in substance, the resource provider's intention was for the resource recipient to receive the specified non-financial resource (i.e. employee services, in the earlier example of funding for the office manager's salary) and that the resource recipient has received a financial resource (i.e. the funding) as an agent for the resource provider (principal). Under this argument the resource recipient could be regarded as holding the financial resources received on behalf of the resource provider. It could be argued that a liability exists until the resource recipient has satisfied the agreed stipulations over use by spending those financial resources on acquiring the specified non-financial resources (employee services). Under this argument, revenue is recognised when the non-financial resources are acquired, as would occur if the resource provider had directly provided those non-financial resources (e.g. if the resource provider had instead contributed the time of its own employee to the resource recipient). In other words, this argument treats the arrangement as being, in substance, a contribution of non-financial (rather than financial) resources to the resource recipient, with the earlier receipt of those financial resources viewed as being received in an agency capacity. However, in considering this argument, we note that the resource recipient gains control over resources when it receives the funding and that the only "obligation" on the entity is to exchange one type of resource (the funding) for another type of resource (the employee services), i.e. an exchange of assets, as noted earlier. Therefore, while we understand the argument, we concluded that such arrangements do not create obligations that meet the definition of a liability. Put another way, we believe the "substance" of the arrangement is the contribution of a financial resource with a restricted use, rather than the contribution of a non-financial resource with earlier receipt of the financial resource being received in an agency capacity.

We acknowledge that the Conceptual Framework's discussion of "other obligations" could be applicable for this category of transactions. Although, in our view, these transactions do not impose obligations on the resource recipient that meet the definition of a liability, the existence of enforceable stipulations over the use of the funding could be considered "obligations" in the broader sense. Even though the liability definition is not satisfied, some might argue that this category of transactions is sufficiently similar to the category of transactions with performance obligations (i.e. in which a liability does exist) to justify the deferral of revenue recognition for unsatisfied stipulations under the "other obligations" approach. We also acknowledge the challenges for resource recipients in telling their performance story if revenue is recognised before the spending which satisfies those stipulations occurs. However, 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 resource 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 resource recipient's performance story, while also faithfully representing the resource recipient's financial position.

Transactions with consumption-based stipulations and no enforcement mechanisms

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.

Transactions with time-based stipulations

For revenue transactions with no performance obligations or stipulations over use, other than time requirements, the restrictions as to when the funds must be used does not impose an obligation on the entity 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.

Presentation of revenue arising from transactions with stipulations

We are aware that the upfront recognition of revenue in transactions with stipulations can make it difficult for entities to explain what they consider to be their performance story. We have therefore considered two options that could be used to provide more detailed information about revenue arising from transactions with stipulations (but not performance obligations), including transactions with time-based stipulations. 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: the stipulations could be about 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 its financial statements. This option would help to educate users to focus not only on the surplus or deficit (the "bottom line") but to also look at what makes up the surplus or deficit.

   If this option is adopted, we recommend the IPSASB develops guidance on how to determine when the fulfilment of the stipulations has occurred. For example, for transactions with time requirements, the stipulation could be treated as being met on a straight-line basis over the specified period of time or only at the end of that time period (i.e. when the time stipulation has lapsed).

   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. It 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 would 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 resource 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 stipulations are fulfilled, the amount initially reported in OCI would be recycled to revenue in surplus or deficit.

Under the OCI option (as with the presentation option), it will be important to provide guidance on determining when the resource recipient has satisfied the agreed stipulations, to allow OCI to be recycled to surplus or deficit in the appropriate reporting period. For consumption-based stipulations, OCI could be recycled based on when the resource recipient has used the funding in the manner specified. For time-based stipulations, OCI could be recycled using a straight-line basis over the specified time period or at the end of that period (i.e. when the time stipulation has lapsed).

Our suite of Public Benefit Entity (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 the concept of OCI, and this concept was carried forward into our suite of PBE Standards.

This option keeps the items recognised in the statement of financial position 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 OCI or equivalent section.

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 ongoing existence of stipulations on resources in the statement of financial performance. It is more likely to result in revenue being included in surplus or deficit in the same periods as those in which the resources are used.

This option would work only if the IPSASB introduces OCI into the IPSAS literature and mandates the presentation of a statement of other comprehensive income or an equivalent presentation approach (i.e. if this approach were adopted, it should apply to all instances in which revenue or expenses are recognised directly in net assets/equity under current IPSAS literature, such as when accounting for cash flow hedges in accordance with the standards for financial instruments). This option would not work if the resources were recognised directly in net assets/equity. If the resources were recognised directly in net assets/equity, this would be less transparent and potentially misleading, as it would present a message that the resource recipient has not benefited from receiving the resources, which would not reflect the substance of the transaction.

Whilst we consider it important that the presentation of a statement of comprehensive income is mandatory, we consider that application of the OCI accounting treatment for the recognition of revenue for this category of transactions should be optional for entities receiving this type of funding. This could be either an accounting policy choice or applied on a transaction-by-transaction basis. The resource recipient could choose to apply this accounting treatment if the benefits outweigh the costs. Although we recognise that, because of the potential impact on comparability, providing such entities with an accounting treatment option is not ideal from a standard-setting perspective, we could see some analogies with cash flow hedge accounting in IFRS Standards. In both cases:

- the objective of the OCI accounting treatment is to address an accounting recognition mismatch between one transaction and another closely related transaction, and thereby provide users of the financial statements with a clearer and more complete picture of the entity’s financial performance; and
- because the accounting treatment could be costly for preparers to apply, preparers have the option to apply the treatment only when the benefits are expected to exceed the costs.

With respect to the importance of considering costs and benefits, we have received feedback from some constituents about the importance of ensuring that the accounting for revenue transactions with stipulations is simple for preparers to apply. We note that some resource recipients are not significantly impacted by any mismatch between the timing of when funding is received and when it is used as specified by the resource provider. For these entities, application of an OCI accounting treatment would introduce additional complexity without necessarily providing significant benefits to users of their financial statements. By making application of an OCI accounting treatment optional, we expect that individual entities would consider whether the benefits would outweigh the costs, similar to cash flow hedge accounting.

In considering this OCI accounting treatment, 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 ongoing 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.

Our preference on whether to use the presentation option or OCI option

In suggesting that the IPSASB considers both the presentation option and the 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 in one period but satisfied those stipulations in a different period. 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 expenses 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 opinion, the analysis of those transactions discussed in the CP 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.[5]

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

[5] 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.

In addition, other than a brief reference in paragraph 6.40 of the CP, that the delivery of universally accessible services and collective services may involve a number of exchange transactions, the CP has not discussed the various stages of implementing a programme of delivering services to the public. This has made it difficult for the NZASB to assess when the obligating event arises and to whom the obligation arises, under the proposed recognition approaches in the CP.

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.[6]

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

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

resource provider imposes on the resource recipient performance obligations and those without performance obligations.

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 performance obligations[7] on the resource recipient, we propose applying a PSPOA to expenses (simplified).

We do not envisage that 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 that 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 Extended Obligating Event Approach (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 –

[7] 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 or 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. As noted earlier, our constituents have also experienced issues with this classification; 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.

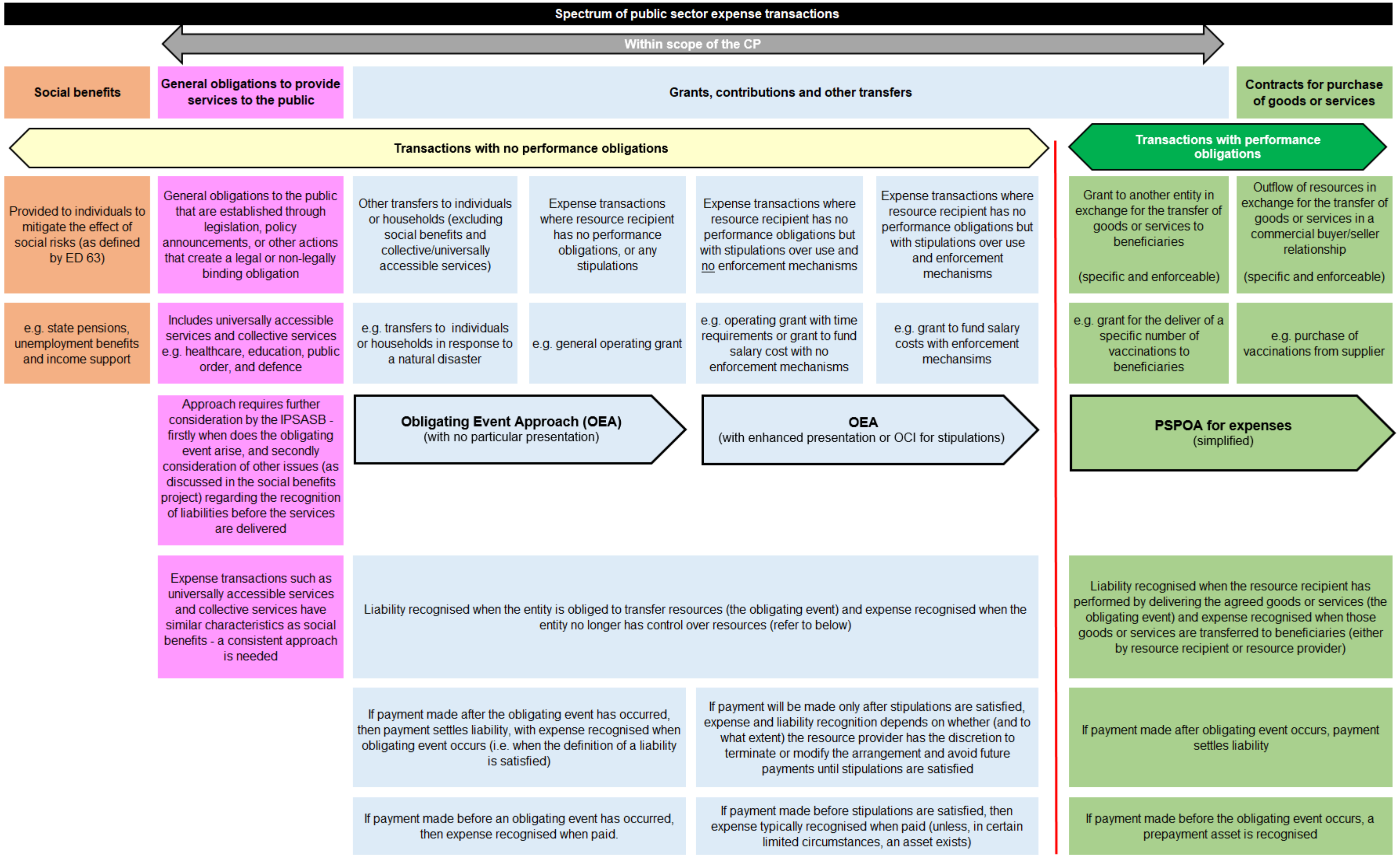
The alternative OEA proposed by the NZASB does not focus on whether the resource recipient has unfulfilled restrictions or conditions, because typically the fulfilment of these stipulations would be outside the control of the resource provider. For example, if the resource provider has already transferred 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 does 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

Social benefits and general obligations to provide services to the public

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 Exposure Draft 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 the purpose of this comment letter, the NZASB considers that the determination of an obligating event for social benefit schemes is not substantively different from the determination of an obligating event for general obligations to provide services to the public, including 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 obligations for benefits to be 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. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability.[8]

[8] Paragraph 5.22 of the Conceptual Framework

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 and, under current accounting standards, an entity would not 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 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) announcement 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

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.

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

We note that the CP proposes a PSPOA for these non-exchange expenses. We do not consider that this is 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, and 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— 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 would 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 in the statement of financial performance and then take it 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 would be recycled from the separate reserve to an expense in surplus or deficit.

   This option would keep the items recognised in the statement of financial position 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 OCI or equivalent section.

   This option would work only if the IPSASB introduces OCI into the IPSAS literature and mandates the presentation of a statement of other comprehensive income or an equivalent presentation approach, as discussed earlier in our comments on revenue recognition. 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.

   Whilst we consider it important that the presentation of a statement of comprehensive income is mandatory, we think that application of the OCI accounting treatment for the recognition of expenses should be optional for entities providing this type of funding, as discussed earlier in our comments on revenue recognition for this type of transaction. The resource provider could choose to apply this accounting treatment if the benefits outweigh the costs.

> However, 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 be permitted only when the resource provider has the ability or mechanisms in place to monitor the resource recipient's progress towards satisfying the agreed stipulations. In addition, even if the IPSASB decided to adopt this OCI approach for revenue transactions with stipulations attached, there are some arguments that it does not necessarily mean that a similar approach should be applied to expense transactions. We comment further on this point later.

For these transactions with no performance obligations but which have stipulations over use and no enforcement mechanisms, we are proposing the OEA be applied, together with 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 exists only 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 to 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 has no control over how and when the resource recipient will meet that requirement and 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).

<u>Grants, contributions and transfers to other entities — no performance obligations but with stipulations and enforcement mechanisms</u>

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 we did in relation to 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” [9] 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, 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 has already lost control of resources 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.

[9] Conceptual Framework, paragraph 5.4

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 (subject to our comments below about whether these options should be applied in the context of expense recognition, even if adopted for revenue recognition).

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).

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) an asset can be measured in a way that achieves the qualitative characteristics (see discussion below).

In order to recognise an asset, one factor to consider is measurement. In order to faithfully represent the resource provider's potential repayment claim that measurement would need to take into account the likelihood of the resource recipient failing to meet the stipulations. An inflow of resources back to the resource provider would be conditional on the resource recipient failing to satisfy the stipulations. That could mean that any asset would be for a very small amount or immaterial. Other measurement factors include whether, in the event of failing to meet an agreed stipulation, the resource recipient would have the resources available to return the funds and the time value of money, if significant.

In order to provide public sector and not-for-profit (NFP) entities with the funding required to continue operations, grants are often paid before the obligating event. 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, even if no asset is recognised initially when the funding is first provided, the change in circumstances means that the resource provider would need to 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 data about how many resource recipients will not satisfy the stipulations and subsequently return 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 should be netted off against any current grant expenditure or recognised separately as some form of revenue.

Our preference on whether to use the presentation option or the OCI option

Overall, the NZASB has similar views on which approach to apply as discussed earlier in the context of revenue recognition. 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. In particular, they note that the OCI option could be justified for the resource recipient on the grounds that there is a timing mismatch between the receipt of resources and spending of those resources, i.e. the resource recipient enters into two linked transactions relating to the stipulations – the imposition of those stipulations on receipt of the funding and the subsequent fulfilment of those stipulations by using that funding as specified. In contrast, the resource provider enters into only one transaction relating to the stipulations – the provision of funding with stipulations. Because there are no stipulations imposed on the resource provider (they are imposed by the resource provider on the resource recipient) the above "timing mismatch" does not arise for the resource provider. Therefore, the argument for an OCI option for the resource provider is less clear, compared with the resource recipient, and it could even be viewed as misleading for the resource provider to apply this approach. Also, 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 expenses should also be considered. Before the IPSASB develops this option for expenses, we recommend the IPSASB obtains feedback on the appropriateness of the proposal from other constituents.

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

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, we consider that the PSPOA for expenses should apply only to transactions with performance obligations. 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 with enforcement mechanisms 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[10] and the IFRS Standards. An IPSAS based on IFRS 15 would assist the readers of these entities' financial statements by avoiding 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 are already covered in the *Broadened for the Public Sector* sections of the CP chapter 4, but we wanted to stress their importance for when the IPSASB develops an IPSAS based on IFRS 15.

10 PBE Standards are based on IPSASs

- Enforceability – what is enforceability in the public sector? The AASB noted that 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 which enforcement mechanisms in the public sector would result 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 that 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.[11] 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.[12] 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 at the time of making the donation. Often this intent is not known due to a lack of evidence.[13] 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. Some 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 under the PSPOA). For some public sector entities, accounting for licence

[11] AASB 2016-8.BC38

[12] AASB 2016-8.BC49

[13] AASB 2016-8.BC52

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 for the lack of an 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). In making this point, we note that this situation is different from the earlier example discussed in Appendix 1, because in that earlier example there is no direct relationship between the funding and the resource recipient's outputs.

- Output-based appropriations – in New Zealand, certain public sector entities receive funding via output-based appropriations where the resource provider specifies what outputs the resource recipient must deliver with the funding. This can be viewed as either (a) funding the resource recipient or (b) buying outputs from the resource recipient. The resource 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 that 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 and 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. We comment on this further in our response to SMC 1.

However, it is important to note that under our proposed framework, some parts of IPSAS 23 would no longer be applicable. For example, 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 the standard 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 (including whether an appropriation should be treated as revenue or a capital contribution). In our view, a residual revenue standard (or section of a revenue standard) needs to discuss appropriations that are not in the scope of an IPSAS based on IFRS 15 (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 in 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 from transactions that involve the transfer of goods or services to either the resource provider or 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 within the scope of IPSAS 23 that we consider should be accounted for using the PSPOA. As discussed earlier, these are transactions with no explicit return condition, but which have other enforcement mechanisms 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 from transactions with three party arrangements (resource provider, resource recipient and 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 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). However, many of the definitions and guidance in IFRS 15 are focused on two party arrangements, which are the most common form of transaction in the for-profit sector, whereas three-party transactions are more common in the public sector.

- 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 that 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.[14]

[14] 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 obligation

- 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 the performance obligations and unbundling performance obligations into those that are distinct (and hence accounted for separately from other 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. While some level of specificity is necessary (e.g. to conclude that the arrangement includes performance obligations and determine when those obligations have been satisfied), that does not mean a high level of specificity is necessary. We encourage the IPSASB to develop guidance on identifying performance obligations in a public sector context. In doing so, we also encourage the IPSASB to consider the nature of public sector transactions and provide guidance on identifying performance obligations using principles rather than being prescriptive. This would allow the resource recipient to apply its judgement in identifying performance obligations based upon the terms of each particular arrangement.

- To assist resource recipients in identifying specific performance obligations within binding arrangements in the public sector, we suggest the following factors[15] 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.

  We are not suggesting that all of these factors need to be present or that there are not other factors that could be relevant. Rather, we think that these are examples of factors that are likely to be helpful in identifying performance obligations. In general, for a performance obligation to be considered specific enough for the PSPOA to be applied, these are the types of factors that would assist with making that assessment.

- 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.

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[15] AASB 2016-8.F20

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

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 which do have 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 with 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 and the timing of fulfilment of those stipulations. 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 also 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.[16]

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.[17] 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).[18] 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 develops guidance on how to present the fulfilment of the stipulations. If the IPSASB intends to use the restricted and non-restricted concepts, there needs to be appropriate basis for transferring resources from restricted to unrestricted when the stipulations are met. For example, for transactions with time requirements, the fulfilment of the stipulation could be recognised as the resources are consumed (if feasible), on a straight-line basis, or when the time has lapsed.

16 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

17 Equivalent to a statement of financial performance

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

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 assist preparers in applying this option, we recommend that the IPSASB develops illustrative examples.

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, the amount initially reported in OCI is recycled to revenue in surplus or deficit.

Under the OCI option it will be important that the resource recipient has the ability to demonstrate the satisfaction of the agreed stipulations, to allow OCI to be recycled to surplus or deficit in the appropriate reporting period. For consumption-based stipulations, OCI could be recycled based on the satisfaction of agreed stipulations and, for time-based stipulations, OCI could be recycled using a straight-line basis or when the time has lapsed.

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 items recognised in the statement of financial position 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 OCI or equivalent section.

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 ongoing existence of stipulations on resources in the statement of financial performance. It is more likely to result in revenue being included in surplus or deficit in the same periods as those in which the resources are used.

This option would work only if the IPSASB introduces OCI into the IPSAS literature and mandates the presentation of a statement of other comprehensive income or an equivalent presentation approach (i.e. if this approach were adopted, it should apply to all instances in which revenue or expenses are recognised directly in net assets/equity under current IPSAS literature, such as when accounting for cash flow hedges in accordance with the standards for financial instruments). This option would not work if the resources were recognised directly in net assets/equity. If the resources were recognised directly in net assets/equity, this would be less transparent and potentially misleading, as it would present a message that the resource recipient has not benefited from receiving the resources, which does not reflect the substance of the transaction.

Whilst we consider that the presentation of the statement of comprehensive income should be mandatory, we think that application of the OCI accounting treatment for the recognition of revenue should be optional, for the reasons explained more fully in Appendix 1. In summary, there are cost/benefit concerns with applying this approach. Hence, making it optional would enable the resource recipient to apply this accounting treatment only if the benefits outweigh the costs. Mandating this accounting treatment would create extra compliance costs for resource recipients, particularly for those entities that are not significantly impacted by time requirements or other stipulations over use.

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 involved 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 were to retain 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 its 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 resource recipient would recognise the inflow of resources in OCI in 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 in surplus or deficit. 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 ongoing 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, as discussed earlier. This approach would not work if the resources were recognised directly in net assets/equity. If the resources were recognised directly in net assets/equity, this would be less transparent and potentially misleading, as it would present a message that the resource recipient has not benefited from receiving the resources, which would 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 costs.

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 necessarily 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. We plan to comment separately on ED 63 *Social Benefits*. At this stage, our view is that the determination of an obligating event for social benefit schemes is not substantively different from the determination of an obligating event for 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. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability.[19]

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.[20] 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 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.

[19] Paragraph 5.22 of the Conceptual Framework

[20] Paragraph 5.22 of the Conceptual Framework

Other than the brief reference in paragraph 6.40 of the CP, that the delivery of universally accessible services and collective services may involve a number of exchange transactions, the CP has not discussed the various stages of implementing a programme of delivering services to the public. This has made it difficult for the NZASB to assess when the obligating event arises and to whom the obligation arises, under the proposed recognition approaches in the CP. 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 satisfied, 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 purported scope of chapter 7 of the CP is therefore broader than the receivables and payables discussed in the chapter.

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 in relation to those transactions should be in accordance with an IPSAS based on IFRS 15. Subsequently, any impairment of such receivables would be 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 purported 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 to subsequent measurement has appeal because it appears the most workable of the three approaches to apply in practice. However, we would recommend that the IPSASB determine the presentation and disclosure requirements for statutory receivables starting from scratch, rather than looking to adopt 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 and would therefore 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 discounted cash flows 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 responses 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 approach to the measurement of non-contractual payables, and, as noted in the CP, is the approach currently used by some jurisdictions.