

Swiss Comment to

ED 72 Transfer Expenses

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1. Introduction

The Swiss Public Sector Financial Reporting Advisory Committee (SRS-CSPCP) was established in 2008 by the Swiss Federal Ministry of Finance together with the 26 cantonal Ministers of Finance. One of its aims is to provide the IPSAS Board with a consolidated statement for all three Swiss levels of government (municipalities, cantons and Confederation).

The SRS-CSPCP has discussed the ED 72 Transfer Expenses and comments as follows.

2. General Remarks

The SRS-CSPCP welcomes that with this ED a gap in the recording of transfer payments is closed. The mirroring with the Revenue Standards (ED 70 and ED 71) is very successful. The different possibilities or requirements for recording expenses without performance obligation are, however, considered to be problematic and the complexity of the ED seems high.

The SRS-CSPCP would like various matters to be clarified or treated in more detail.

- The SRS-CSPCP finds that, in contrast to ED 71, the transfer contributions are not governed. It should be clarified in particular how such transfer payments which pass through several levels of government, have to be treated. Transfer contributions are contributions, which the public sector entity A has received from another public sector entity B (revenue) and are passed on in full to third parties C (expense). Expense is incurred by both A and B, A and C record revenue. The recording should be governed for all entities. This is an important element, especially in countries, which are organized federally and decentralized, with several levels of government.
- A definition of present obligations (analogous to ED 71) is lacking. It is therefore unclear whether or not eligible expenditure also qualifies as present obligations.
- Certain topics are not treated or treated only in passing. This concerns in particular grants for capital expenditure and some cost-free transfers of assets and financial guarantees. Free transfers of assets are quite important for Swiss public sector entities. Transfers in form of services provided free of charge by a public entities to other public or private entities are also numerous. This explains why the SRS-CSPCP was called upon to offer accounting guideline in this regard. So did it by issuing an answer to this FAQ. The French version of this answer is included as an appendix to this comment.
- Also not treated are lease contracts, when the property is not used directly by the lessee, but by a third party or by the lessor (another administrative unit). The question arises whether this would have to be treated analogously to IPSAS 13 – Leases or whether here ED 72 is applicable.
- By comparison with the Consultation Paper the time requirements on the provider side are no longer mentioned. This is problematic above all in the case of promised annual contributions; it is not clear whether or not they are subject to a present obligation. If so, the expense cannot be recorded in the correct period. If for example the Confederation (central government) concludes a performance agreement with the universities for 4 years, pursuant to ED 72 it must record the expense for the entire 4 years when closing the accounts, because from this date a performance agreement exists (and the annual budget agreement by the Parliament is only formal in nature). Furthermore, prepayments result in earlier expense, ex post payments to later expense.
- It is in some case difficult to determine whether or not a binding arrangement is given and at what time the current obligation arises. The expression binding arrangement is also in part unclear. A binding arrangement arises not only through mutuality but also through legal obligations. These should, however, not be seen as less binding than a binding arrangement.

- As already in the discussion of the revenue side (ED 70 and ED 71), it is considered important that, to the extent possible and sensible, expense and revenue are recognized symmetrically. By the way the SRS-CSPCP expressed this wish already in the Consultation Paper of August 2017. Further the SRS-CSPCP would have liked the IPSASB to treat the expense and revenue sides in the same ED.
- In particular in respect of the application examples, the Standard is less focused on the problems of a public sector entity.

The SRS-CSPCP welcomes the fact that the performance obligation approach will be implemented only if the performance of the transfer provider can be checked.

The SRS-CSPCP would like to draw attention to two possible errors:

1. Step 5 (Paragraph 30ff) is described before Step 3 (Paragraph 46ff) and Step 4 (Paragraph 72).
2. Comparing Paragraph 32 of ED 70 with Paragraph 35 of ED 72 (or also with IFRS 15 – Paragraph 33) it is noticed that the definition of Control has not been taken over in its entirety in ED 70.

This paragraph is included in IFRS 15, but not in ED 70:

“Control of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the benefits from an asset.”

This paragraph is included in ED 72, but not in ED 70:

“Control of an asset, which is defined in (draft) IPSAS (ED 70) refers to the ability of the third-party beneficiary to direct the use of, and obtain substantially all of the remaining benefits or service potential from, the asset. Control includes the ability to prevent other entities from directing the use of, and obtaining the economic benefits or service potential from, an asset.”

The SRS-CSPCP wonders whether these are errors or whether there is a reason for this presentation.

3. Specific Matter for Comment 1

The scope of this [draft] Standard is limited to transfer expenses, as defined in paragraph 8. The rationale for this decision is set out in paragraphs BC4–BC15.

Do you agree that the scope of this [draft] Standard is clear? If not, what changes to the scope or definition of transfer expense would you make?

The SRS-CSPCP takes note that concessionary loans are explicitly not included in this Standard. However, it wonders whether financial guarantees should also not be excluded. An addendum in Paragraph 5 of this standard would be desirable.

While goods and services in kind are mentioned in this ED, the recording of such services seems to be optional. Goods and services in kind may, however, involve significant amounts. If they are not recorded, the financial position and revenue and expense of a public sector entity cannot be reliably evaluated. The SRS-CSPCP therefore wishes that the recording of such services, above all on the provider side, be required in the new Standard and therefore also governed, even when it is clear that the value of goods and services in kind is difficult, but not impossible to estimate. On the provider side the estimation of the value of goods and services in kind is not particularly difficult, and therefore for the provider side stricter rules should apply.

4. Specific Matter for Comment 2

Do you agree with the proposals in this [draft] Standard to distinguish between transfer expenses with performance obligations and transfer expenses without performance obligations, mirroring the distinction for revenue transactions proposed in ED 70, Revenue with Performance Obligations, and ED 71, Revenue without Performance Obligations? If not, what distinction, if any, would you make?

The SRS-CSPCP is in agreement with the proposed distinction. It points out however that the distinction between expenses with performance obligation and those without performance obligation is in practice sometimes difficult to implement. This distinction is particularly difficult, if they are services to third parties. The following examples illustrate the difficulties:

Example 1: A canton pays for air filters to a waste incineration plant, in order that the air complies with the legal requirements. Depending on who is the beneficiary, it is either an expense with performance obligation (the beneficiaries are the residents of the canton) or an expense without performance obligation (the beneficiary is the waste incineration plant).

Example 2: Based on an inter-state treaty the Confederation (central government) pays a grant for capital expenditure to a canton (one of the 26 states) for a water project. This lasts four years and millions are approved. The canton uses part of the money for the river correction; but the canton has no performance obligation, but a present obligation for the money, which it retains. Part of the money is passed on by the canton to its municipalities, in order that they, for example, can maintain the water supply. Here it is unclear whether it is a performance obligation or a present obligation of the municipalities. And so it is unclear whether the Confederation must recognize the total expense on signature of the state treaty.

Example 3: This concerns payments by the Confederation to the Swiss Federal Technical High School (ETH), for which contributions have been approved over several years. Does the present obligation arise with conclusion of the (multi-annual) contract between the Confederation and the ETH, does the Confederation have to recognize the total expense immediately; no accrual is possible. On the other hand, the ETH can recognize the contributions received over the duration of the contract.

Because of this wide possible asymmetry in the recognition, the SRS-CSPCP wishes that the IPSASB defines in more detail what constitutes a performance obligation and what a present obligation and when precisely they arise: at a specific point in time or over a certain period. They would like this to be illustrated by several examples.

The SRS-CSPCP finds that the expressions over time and point in time are not defined in ED 72. There is also no definition of these expressions in the Conceptual Framework. Both derive from IFRS 15 and are also found in ED 70. They are comprehensible here only if ED 70 is already known. But ED 72 should itself be clear enough that prior reading of ED 70 is not necessary.

Furthermore, not governed is how mixed contracts (expenses), that is those with and without performance obligation, are to be treated. On the expense side there is lacking a rule, as is foreseen for the revenue side. If an expense cannot be split up into its various components, the ED does not govern which Standard has to be applied. For the SRS-CSPCP it is clear that the response to SMC 2 belongs in part to SMCs 5 and 6.

5. Specific Matter for Comment 3

Do you agree with the proposal in this [draft] Standard that, unless a transfer provider monitors the satisfaction of the transfer recipient's performance obligations throughout the duration of the binding arrangement, the transaction should be accounted for as a transfer expense without performance obligations?

The SRS-CSPCP is in agreement with the principle of this proposal. However, over a long period it is difficult to ensure the monitoring duty. The monitoring problem arises above all, if third parties are the beneficiaries. The SRS-CSPCP would like *monitoring* to be precisely defined. If definitions are precise, different monitoring practices will be avoided, for example among the various Swiss cantons.

6. Specific Matter for Comment 4

This [draft] Standard proposes the following recognition and measurement requirements for transfer expenses with performance obligations:

- (a) A transfer provider should initially recognize an asset for the right to have a transfer recipient transfer goods and services to third-party beneficiaries; and*
- (b) A transfer provider should subsequently recognize and measure the expense as the transfer recipient transfers goods and services to third-party beneficiaries, using the public sector performance obligation approach.*

The rationale for this decision is set out in paragraphs BC16–BC34.

Do you agree with the recognition and measurement requirements for transfer expenses with performance obligations? If not, how would you recognize and measure transfer expenses with performance obligations?

- (a) As already mentioned under SMC 2, the difficulty is the distinction between expenses with or without performance obligation. If this difficulty is eliminated and if an expense can be clearly identified as one with performance obligation, the SRS-CSPCP is in agreement with the recognition rules for transfer expense with performance obligation.*
- (b) According to Paragraph 66 of the ED non-cash assets should be transferred at carrying amounts. The SRS-CEPCP is of the opinion that this should be at market values.*

The SRS-CSPCP is also of the opinion that BC 28 is not clearly formulated. The objective of a "right" as defined under BC 28 is interpreted as an objective of a resource and not a receivable. Clarification by the IPSASB is desired, as to how this right is to be recognized in the balance sheet.

7. Specific Matter for Comment 5

If you consider that there will be practical difficulties with applying the recognition and measurement requirements for transfer expenses with performance obligations, please provide details of any anticipated difficulties, and any suggestions you have for addressing these difficulties.

The SRS-CSPCP sees various difficulties in applying the recognition and measurement requirements for transfer expenses with performance obligation. Firstly, the difficulty of knowing at all whether there is a performance obligation or a present obligation. The example of contribution to a canton and also the example of contributions to a waste incineration plant (see response to SMC 2) illustrate these difficulties very well. A further point is the monitoring, as was mentioned in the response to SMC 3. In addition, there is a risk that, if the difficulties are greater, the transfer expenses will be considered to be without performance obligation.

8. Specific Matter for Comment 6

This [draft] Standard proposes the following recognition and measurement requirements for transfer expenses without performance obligations:

- (a) *A transfer provider should recognize transfer expenses without performance obligations at the earlier of the point at which the transfer provider has a present obligation to provide resources, or has lost control of those resources (this proposal is based on the IPSASB's view that any future benefits expected by the transfer provider as a result of the transaction do not meet the definition of an asset); and*
- (b) *A transfer provider should measure transfer expenses without performance obligations at the carrying amount of the resources given up?*

Do you agree with the recognition and measurement requirements for transfer expenses without performance obligations?

If not, how would you recognize and measure transfer expenses without performance obligations?

- (a) According to the ED a present obligation arises, when a binding agreement is concluded. At this point the total expense must also be recognized. As already mentioned in the Example in SMC 2, it is difficult to establish the time, at which a present obligation arises. And above all the transfer provider is confronted by severe problems if the present obligation arises at the beginning of a multi-annual contract. The SRS-CSPCP wishes that it is clarified whether under a multi-annual contract the present obligation arises for the provider at the beginning of the contract or whether it arises again each year. This cannot be clearly seen from the ED, but for the recognition of expense in the transfer provider it is of key importance.

In example 34 (IE180 to IE182) there is also talk of "future performance". Although the example of one is for a present obligation, a kind of performance obligation approach is mentioned. For the user this is unclear and contradictory. There is another contradiction between AG 94 and AG 95. In AG 94 it is stated that expense is recognized when the present obligation arises or when payment is made, if this is earlier; in AG 95 it is stated that prepayments may be accrued, if it is an expense with present obligation. This therefore accords with the rule for prepayments under contracts with performance obligation. They are not implemented until fulfillment of the obligation. The question arises how prepayments per AG 95 can be distinguished from the case in AG 94. This should be more clearly evident from the ED.

As already mentioned in the response to SMC 2, it should be more clearly evident under what circumstances a present obligation arises over a certain time.

- (b) According to Paragraph 114 of the ED *non-cash assets* should be transferred at carrying amounts. The SRS-CSPCP is of the opinion that this should be at market values.

9. Specific Matter for Comment 7

As explained in SMC 6, this [draft] Standard proposes that a transfer provider should recognize transfer expenses without performance obligations at the earlier of the point at which the transfer provider has a present obligation to provide resources, or has lost control of those resources. ED 71, Revenue without Performance Obligations, proposes that where a transfer recipient has present obligations that are not performance obligations, it should recognize revenue as it satisfies those present obligations. Consequently, a transfer provider may recognize an expense earlier than a transfer recipient recognizes revenue.

Do you agree that this lack of symmetry is appropriate? If not, why not?

The SRS-CSPCP is not particularly enthusiastic about this lack of symmetry, but probably has to tolerate it. The problem is that on the provider side given a present obligation the total expense must be recognized too early, but on the recipient side the payment received can be accrued and therefore spread over several financial years. The various asymmetries arise because of the different information available to provider and recipient.

The provider and recipient side should in principle not be treated asymmetrically. But it is possible that the information is asymmetric and therefore symmetrical recognition is not possible. Efficient monitoring can reduce such asymmetrical information. The SRS-CSPCP agrees that in cases with an information asymmetry, recognition may also be asymmetrical. If, as desired under SMC 6, the rules for recognizing expense without performance obligation are clearer, the asymmetries between expense and revenue would probably be less. A distinction must therefore be made between asymmetrical recognition and asymmetrical information.

10. Specific Matter for Comment 8

This [draft] Standard proposes that, when a binding arrangement is subject to appropriations, the transfer provider needs to consider whether it has a present obligation to transfer resources, and should therefore recognize a liability, prior to the appropriation being authorized. Do you agree with this proposal?

If not, why not? What alternative treatment would you propose?

The principle of “*substance over form*” is in the case of binding arrangements and present obligations difficult to implement. The SRS-CSPCP wishes that examples be added from which can be seen how in such cases the budget law has to be applied. In particular is to be clarified whether the present obligation arises with the beginning of the budget year (e.g. 1.1.xxx) or with the decision (e.g. 20.12.xx-1, i.e. in the year preceding the budget). Otherwise the SRS-CSPCP agrees with the proposal.

11. Specific Matter for Comment 9

This [draft] Standard proposes disclosure requirements that mirror the requirements in ED 70, Revenue with Performance Obligations, and ED 71, Revenue without Performance Obligations, to the extent that these are appropriate.

Do you agree the disclosure requirements in this [draft] Standard are appropriate to provide users with sufficient, reliable and relevant information about transfer expenses? In particular,

(a) Do you think there are any additional disclosure requirements that should be included?

(b) Are any of the proposed disclosure requirements unnecessary?

The SRS-CSPCP takes the liberty of repeating the responses to the disclosure requirements in ED 70 and ED 71.

The SRS-CSPCP is of the opinion that the disclosure requirements of ED 72 are too extensive. The SRS-CSPCP is of the opinion that the disclosure requirements are oriented too little to the needs of a stakeholder in the financial report of the public sector.

A cost-benefit relationship should also be observed in respect of disclosure (that implies also that all extensive disclosure requirements must be reviewed for every annual accounts as to whether or not they are material). The disclosure requirements are predominantly of a technical nature. But for the reader of the accounts the substance and possibly the categories of transfer payments are of importance.

Lausanne, September 14, 2020