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13 November 2020

Ian Carruthers
Chair
International Public Sector Accounting Standards Board
277 Wellington Street West
Toronto, ON M5V 3H2
Canada

Dear Mr. Carruthers

Exposure Draft 70 *Revenue with Performance Obligations*

I am pleased to make this submission on Exposure Draft 70 *Revenue with Performance Obligations*.

I have over 30 years of experience in accounting advisory functions of large accounting and auditing firms across a wide range of clients, industries and issues in the for-profit, not-for-profit, private, and public sectors. My clients across the business and government environments have included listed companies, unlisted and private companies, charitable and not-for-profit organisations, commonwealth, state and local government departments and agencies in the public sector, and government owned corporations (government business enterprises).

My current position is at the Queensland Audit Office where we audit Queensland state government entities, universities and local governments.

I have followed the IASB's project on IFRS 15 for over 10 years, and have been involved in the implementation of Australia's equivalent to IFRS 15 (AASB 15) in the public sector.

I include my detailed responses below.

Yours sincerely,

David Hardidge
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Specific Matter for Comment 1:
This Exposure Draft is based on IFRS 15, *Revenue from Contracts with Customers*. Because in some jurisdictions public sector entities may not have the power to enter into legal contracts, the IPSASB decided that the scope of this Exposure Draft would be based around binding arrangements. Binding arrangements have been defined as conferring both enforceable rights and obligations on both parties to the arrangement.

Do you agree that the scope of this Exposure Draft is clear? If not, what changes to the scope of the Exposure Draft or the definition of binding arrangements would you make?

I include comments below on the following issues:
a) Examples
b) Enforcement – Appropriations - "exit" or "termination for convenience" clauses
c) Combining ED71 present obligations with ED70 Performance Obligations
d) History of enforcement – past practice – paragraphs 24 and AG53(c)
e) Enforcement between government departments
f) Sufficiently specific – paragraphs AG35 – 37
g) Research
h) Licences

a) Examples

I will need to update the list I previously sent to IPSASB staff and send separately.

b) Enforcement – Appropriations - "exit" or "termination for convenience" clauses

ED70 needs to further address enforceability in the public sector, particularly in relation to appropriations and what in substance means. Also, how to deal with "exit" or "termination for convenience" clauses. I believe the following comments, that I included in my response to ED71 Specific Matter for Comment 1, are relevant here.

> **b) Enforcement – Appropriations - "exit" or "termination for convenience" clauses**
>
> ED71 needs to further address enforceability in the public sector, particularly in relation to appropriations and what in substance means. Often government transfer providers include an "exit" or "termination for convenience" clause allowing them to avoid paying any extra funding. This is often to ensure that they are not obligated for any payments that have not been appropriated or change in government / priorities. It is common for such clauses to have provisions that the transfer recipient retains funds that have been spent, even if not acquitted for yet (e.g. by regular acquittal reports).
>
> I do not agree that the clauses do not have legal substance. I think that they do have legal substance, i.e. they have "clear economic consequences", "little if any discretion to avoid" and "enforceable by law". I think the clauses do not have economic substance, as they are routinely ignored by transfer recipients.
>
> Applying the above substance reasoning to "exit" or "termination for convenience" clauses would mean that because such clauses are routinely ignored by funding recipients (as shown by similar pricing and terms for arrangements with such clauses and those without such clauses), such

clauses should be considered as being without economic substance. This would be different to the enforceable reasoning applied in ED71.

Some in Australia have argued that "termination for convenience" clauses are a financial liability (refer AASB staff paper AASB November 2020 meeting. However, that paper does not explore the implication of such a view – i.e. that no revenue is recognised for the activities undertaken.

c) Combining ED71 present obligations with ED70 Performance Obligations

I believe the following comments, that I included in my response to ED71 Specific Matter for Comment 3, are relevant here.

> **a) Combining ED71 present obligations with ED70 Performance Obligations**
>
> There appears to be considerable duplication of the ED71 requirements for accounting for binding arrangements with present obligations with the ED70 requirements for performance obligations. I believe it would be much easier if the definition of performance obligation under ED70 was expanded to include the ED71 present obligations to undertake "specified activities" and incur "eligible expenditure". As I noted above, under Specific Matter for Comment 1, that present obligation should be defined as including "specified activities" or incurring "eligible expenditure". I also raised the issue as to whether it is envisaged whether there would be any present obligations under binding arrangements (for funding received) that do not meet those categories.
>
> However, the above suggestion is based on ED72 not requiring "mirror" accounting of ED70 – refer my separate submission on the issue. If IPSASB was to proceed with ED72 largely as proposed ("mirror" accounting for performance obligations), then I believe that ED71 will need to include the duplicated mechanisms of ED70.

d) History of enforcement – past practice – paragraphs 24 and AG53(c)

I disagree with paragraphs 24 and AG53(c) that permits past history of non-enforcement to override the enforcement power. If the power exists, then the agreement is enforceable.

e) Enforcement between government departments

A number of places assume that agreements between departments are legally enforceable (e.g. IE15 and promissory estoppal). In Queensland, the State of Queensland is one legal entity – so the Department of Public Works (for us the Department of Housing and Public Works) is the same legal entity as any other department of the State of Queensland. Consequently, departments of the same legal entity cannot sue each other, or legally enforce agreements.

Whilst cabinet or ministerial directives can be used if there are disputes, they are not always in place before the dispute arises.

The question arises, is an agreement enforceable (between different parts of the same legal entity) when there is no cabinet or ministerial directive in place?

f) Sufficiently specific – paragraphs AG35 – 37

This is a significant issue, and area of confusion, in Australia in applying IFRS 15 / AASB 15 to the not-for-profit sector. The Australian standard has additional guidance on this issue. The underlying requirement is that if the performance obligation is not sufficiently specific, then it is not under AASB 15.

g) Research

Illustrative Example 2 (paragraph IE7 onwards) and Basis for Conclusion paragraph BC34 are drafted on the basis that research grants (that do not involve the transfer of the IP) are not performance obligations. I believe that many research "grants" are funding arrangements for purchased services and should be accounted for under ED70. This area has caused particular problems in Australia as the university sector was the first to adopt AASB 15 (as they have 31 December year ends, coming before the more common 30 June year ends). While deferral under ED71 would achieve the same accounting outcome under the IPSASB proposals (deferral of revenue – something not permitted in Australian in the absence of ED71), the issue is relevant for the proposals under ED72.

Many of the arguments around research fail to acknowledge that not all research is focused on science and technology breakthroughs for IP and patents. Research includes areas such as environmental science and management, and cultural and social outcomes. And accounting. Many research funding arrangements are based on competitive processes and peer review that are for purchased services. Such arrangements often concentrate on the ability and experience of the researcher, not the research institution. It was often the researcher that benefited from the funding arrangements – so the activities are involved in transferring benefits to identified third-parties, as well as society in general.

I cover the following additional issues related to research funding arrangements:
i) Publication as the performance obligation
ii) Sufficiently specific
iii) Recognition of revenue over time

i) Publication as the performance obligation

It is common for research arrangements (that do not involve the transfer of IP) to require some sort of publication at the completion of the research, and with the arrangement not being more specific about the date. One view is that the publication is the performance obligation. I believe that this view misses the purpose of the research arrangements. Using an audit as an analogy, while the output may be considered the audit report (as an analogy to the research publication), the services are not the publication of the audit report, but the audit activities undertaken.

While public publication is often expected in research funding arrangements, sometimes this does not occur and is not critical in the end as knowledge gained from the research is to be translated to practice in other ways.

However, public publication does not determine whether the researcher has provided the promised research activities. That determination is achieved by the researcher reporting to the research councils (the funding bodies) on the use of the funds provided against the promised research activities. As long as the research is conducted in accordance with the arrangement, the researcher is entitled to the funding, regardless of what outcome is reached, or if the researcher publicly publishes the findings.

The reporting obligations on the researcher are such that the research council receives sufficient information for its purposes to encourage further research, and so that it does not unwittingly fund duplicate research, and to inform future funding allocation decisions. This information is provided by researchers irrespective of a public publication. Therefore, public publication does not determine whether the purchased research activities have been performed or not.

ii) Sufficiently specific

Many research funding applications go through a rigorous and competitive process. Funding applications are required to have detailed schedules of the activities to be undertaken. These activities usually included anticipated costings to determine unspent monies. Researchers are required to acquit activities performed against activities promised in the application and return unspent or misspent funds.

I believe that based on work performed so far, for many research funding arrangements, the nature of the detailed project proposals, and the acquittal processes, allows researchers to identify their progress in performing the purchased research activities. Therefore, the “sufficiently specific” requirement is met for such funding arrangements / purchases of research activities.

iii) Recognition of revenue over time

I believe that revenue recognition is appropriate over time under ED70 paragraph 34 (a), as the research activities would not have to be repeated if the arrangement was terminated. In other words, the research activities purchased have been delivered.

I also believe that recognition over time under paragraph 34(c) as justifiable. This reasoning uses an audit as an analogy. When applying ED70 to audit fees, the services provided to the customer are not assessed against the publication of the audit report, but under paragraph 34(c).

Using similar reasoning to audits, the researcher cannot use the activities performed for another research arrangement, as the new research arrangement would not be providing funding for research activities already undertaken. The second limb of paragraph 34(c) is also met, as researchers are entitled to retain funds that have been expended on the promised research activities performed.

h) Licences

The only licences that ED70 addresses as being issued seem to be related to licences of intellectual property (or potentially linked to service concessions.

However, there are many licences issued by public sector entities – this is illustrated in the examples to IPSAS 1 that refer to "Fees, fines, penalties, and licenses" with licences being separated from taxes. ED71 does not refer to licenses.

The Australian equivalent to IFRS 15 included specific public sector modifications for licences. Examples of non-IP licences in Australia include those for:

- Dogs, cats (and other pets)
- Drivers
- Working with children checks
- Liquor sales
- Restaurant / food sales
- Building development applications
- Mining exploration and mining development
- Fishing and other agricultural quotas
- Casinos and gaming
- Spectrum (possibly out of scope to be accounted for under IFRS 16)
- Broadcasting (e.g. radio and television)

Broadly, the Australian specific amendments provide practical expedients for short-term and low value. While these are concepts from the leasing standard, they have been very useful in practice. In practice, many entities choose to recognise on receipt / when due and not spread across time.

For the remainder, issuers had to determine whether a performance obligation was included in the licence. Additional guidance usually lead you down a path that the only performance obligation was the issue of the licence, and consequently the licence fee was recognised on issue. Further, that granting exclusivity was not a performance obligation.

Casinos and gaming

I disagreed with the AASB's conclusions for the casinos and gaming, which seemed to imply upfront revenue recognition. My concerns related to differences in accounting between casino and spectrum licences, and different accounting depending how the payments for the casino were structured (e.g. upfront vs over time).

Casinos vs spectrum

Spectrum licences seemed to be out of scope of the Australian non-IP licence amendments, and instead covered by the Australian equivalent of IFRS 16.

I believe that the spectrum and casino licences have significant similarities. These include that the casino licences:

- are often issued on an exclusive basis
- can be reissued "as new" at the end of the term
- could be used by licensor – while not likely in the current Australian environment, governments in other countries do use these rights for their own operations, i.e. government run casinos, broadcasters and telecommunication companies.

The granting of the exclusive casino licence is not "set and forget". In particular, it does not have stand-alone functionality. The licensor has obligations to maintain the value of the casino licence by maintaining the

integrity of the licence, and not just its exclusivity. These obligations are similar to the lessor of a property under an operating lease that is required to undertake and pay for structural repairs and capital improvements.

Casino licences are much more than a licence to perform an activity like driving a car, registering a car, or working with children checks.

Also, the "same" licence can be reissued "as new" at the end of the term. Very much like a property lease. However, the reissue is based on maintaining the underlying value of the licence. For example, having a clean industry for the casino licence, ensuring that spectrum is used appropriately and having only one user, and having appropriate fish stocks for the abalone licence.

Based on the issues discussed above, I believe that casino licences have significant similarities to spectrum licences, and further, that the licence to operate a casino is a lease of an intangible asset of the government. The main reason is that the government itself could operate a casino – as countries do overseas. Therefore, the operator has a "right to use" the government's asset, the right to operate a casino.

Casino licence revenue recognition – upfront vs over time

I believe that structuring a casino licence such that upfront payment being required, rather than annual payments, should not result in different revenue recognition requirements – apart from time value of money issues as sometimes standards take into account time value of money, and sometimes they do not.

If the government were to issue a 40 year casino licence with annual payments owing, the government would not have a financial asset at commencement of the lease for the 40 payments. This is because the government would not have the contractual right to receive those payments, other than through the passage of time. The right to future payments would be conditional on the licensee having behaved properly in the previous year.

Therefore, revenue would be recognised each year, and not upfront.

If the reasoning above is accepted (lease of an intangible asset, or as performance obligations to the general public are performed), revenue would be recognised over time – the same accounting as if annual payments were required.

Specific Matter for Comment 2:
This Exposure Draft has been developed along with [draft] IPSAS [X] (ED 71), *Revenue without Performance Obligations*, and [draft] IPSAS [X] (ED 72), *Transfer Expenses*, because there is an interaction between them. Although there is an interaction between the three Exposure Drafts, the IPSASB decided that even though ED 72 defines transfer expense, ED 70 did not need to define "transfer revenue" or "transfer revenue with performance obligations" to clarify the mirroring relationship between the exposure drafts. The rationale for this decision is set out in paragraphs BC20–BC22.

Do you agree with the IPSASB's decision not to define "transfer revenue" or "transfer revenue with performance obligations"? If not, why not?

I agree with the decision.

Specific Matter for Comment 3:
Because the IPSASB decided to develop two revenue standards—this Exposure Draft on revenue with performance obligations and ED 71 on revenue without performance obligations—the IPSASB decided to provide guidance about accounting for transactions with components relating to both exposure drafts. The application guidance is set out in paragraphs AG69 and AG70.

Do you agree with the application guidance? If not, why not?

I have been involved in few arrangements that combine ED70 revenue with performance obligations, ED71 revenue with present obligations, and ED71 revenue without present obligations. The one I had in mind involved a hospital services arrangement between the coordinating department of health, and related (but not controlled by the department) hospitals.

In the agreement, there are broad requirements:

- Fees for services (hospital admissions, operations etc.) based on DRG (diagnostic related groups). Also included are adjustments for over-performance and under-performance. i.e. ED70 revenue with performance obligations.
- Funding for specified projects (more like incurring eligible expenditure than specified activities as defined under ED71). i.e. ED71 revenue with present obligations.
- "Block" funding for operational expenses (essentially donations). i.e. ED71 revenue without present obligations.

Whilst I believe, when using common sense, you could allocate the funding to the various components, I have not assessed whether this would work under the actual wording of the standards.

I specifically note that I do not believe that there is a refund obligation for the funding for specified projects. Enforceability comes through other mechanisms. I also understand any unspent funds (that usually does not happen very often) are rolled-over into the next year.

Specific Matter for Comment 4:
The IPSASB decided that this Exposure Draft should include the disclosure requirements that were in IFRS 15. However, the IPSASB acknowledged that those requirements are greater than existing revenue standards.

Do you agree that the disclosure requirements should be aligned with those in IFRS 15, and that no disclosure requirements should be removed? If not, why not?

General comments

I believe the following comments, that I included in my response to ED71 Specific Matter for Comment 6, are relevant here:

I make few comments as I have not spent much time on this topic.

In Australia, we have had to distinguish revenue received under AASB 15 (IFRS 15) and the general income standard (AASB 1058). Australian past practice has been to not recognise present obligations for binding arrangements as defined in ED71.

Disclosures for local governments (who receive a variety of funding, and have their own taxes), using these proposals would be required to split between:

- revenue received at a point in time, or over time (with some differences of view with rates – are they at a point in time (the taxable event at the start of the financial year), or over time (as they apply to the financial year)
- and split between ED70 and ED71

Personally, I do not think users are going to be fussed whether revenue is recognised under performance obligations (ED70) or present obligations (ED71). I refer above to my comments above under Specific Matter for Comment 1 on combining the performance obligations and present obligations accounting into the one standard – subject to ED72 not going ahead as proposed.

Specific Matter for Comment 5:
In developing this Exposure Draft, the IPSASB noted that some public sector entities may be compelled to enter into binding arrangements to provide goods or services to parties who do not have the ability or intention to pay. As a result, the IPSASB decided to add a disclosure requirement about such transactions in paragraph 120. The rationale for this decision is set out in paragraphs BC38–BC47.

Do you agree with the decision to add the disclosure requirement in paragraph 120 for disclosure of information on transactions which an entity is compelled to enter into by legislation or other governmental policy decisions? If not, why not?

Paragraph IE250 (illustrating paragraph 120 disclosures). I believe this disclosure could be in a table, including recognising the gross in the note, and then having a discount deduction – for example, the following illustrative disclosures (for local government):

General rates
Separate rates
Water charges
Sewerage charges
Waste management
Garbage charges
Total rates and utility charge revenue
Less: Discounts
Less: Pensioner remissions
Total Rates, levies and charges

Other comments

I include comments below on the following issues:
a) Purchaser or third-party beneficiary
b) Payment in advance
c) Social benefit bonds

d) Illustrative Example comments
e) Editorial

a) Purchaser or third-party beneficiary

The following areas should be updated for the reasoning that the customer is the purchaser or a third-party beneficiary, and not just refer to the purchaser / funder:

- Paragraph 37
- Paragraph AG43(b)
- Paragraphs AG44 to AG48
- Paragraph AG60(b)

b) Payment in advance

Paragraph AG50 should be expanded to clarify the situation when payment is in advance – i.e. only have to repay the unspent money

c) Social benefit bonds

I included the following in my response to ED72 that I think is relevant here:

In practice, I have come across issues with social benefit bonds. These are also referred to as "pay for success". Government pays on successful outcomes, based on defined criteria. The aim is to reduce long-term government spending, e.g. on homelessness, youth criminal reoffending. The measurement period will usually include periods after the end of the minimum payment period, due to the time lag in the private sector organisation's actions and outcomes.

The government may pay a minimum amount (e.g. a standing charge). The private sector providers will provide their own money (raised through the social benefit bonds) to fund the activities. The private sector providers then get paid based on success. Those success payments are used to offset costs, and the remainder is then repaid to the social benefit bond holders.

Issues include:

- Are these performance obligations? Recipients get paid for performance, but there may not be any minimum performance – though they get paid for success – e.g. above a benchmark. So, are the targets "sufficiently specific" to meet requirement for a performance obligation under ED70? I believe that these are performance obligations and that ED70 accounting is appropriate, rather than ED71 accounting.

…

d) Illustrative Example comments

Example 5 – paragraph IE17 onwards

I do not agree that the Resident controls the building at the inception of the arrangement, as I would not expect them to be able to sell the building, borrow against it etc. Specifically, what happens if there is default on the payment – does the Resident lose tenancy, or is the building sold and the Resident receives the excess (if any) proceeds.

There is a series of IFRS Interpretations Committee Agenda Decisions that may assist on this issue

Example 7 – Implicit price concession

The example should be expanded to deal with the accounting for post-sale variation in consideration (i.e. actually receiving the full due amount)

Example 18 – Assessing alterative use and right to payment

This example should explain that recovery for costs incurred relates to public sector pricing and represents a nil margin

Example 21 – Assessing whether a performance obligation is satisfied at a point in time or over time

There is a series of IFRS Interpretations Committee Agenda Decisions that may assist on this issue

e) Editorial

Paragraph IE205 - CU 153 should be CU 153,000