BRITISH COLUMBIA

November 1, 2020

396536

John Stanford
Technical Director
International Public Sector Accounting Standards Board
277 Wellington St. West
Toronto, ON M5V 3H2
E-mail: johnstanford@ipsasb.org

Dear John Stanford:

RE: <u>Exposure Draft 71: Revenue Without Performance Obligations</u>

Thank you for the opportunity to provide comments on the exposure draft; *Revenue Without Performance Obligations*. The views expressed in this letter reflect the views of the Government of the Province of British Columbia, including central agencies, ministries and entities consolidated into the British Columbia Summary Financial Statements. The Summary Financial Statements of the Province are prepared in accordance with Canadian Public Sector Accounting Board (PSAB) standards. We have an interest in the development of the International Public Sector Accounting Standards Board's (IPSASB) guidance as it may influence future PSAB standards.

Comment Period Extension

Even with a large team of experienced accounting professionals, we found it difficult to review all the material provided in the time allowed, particularly when combined with Exposure Drafts 70 and 72 and the effects of the global COVID-19 pandemic. While we appreciate the deadline extension from September 15, 2020 to November 1, 2020, we are concerned that many stakeholders will not have the resources to adequately review these complex and lengthy documents within the current requested response date. We recommend that an additional extension to the comment period be provided.

…/2

Alignment with IFRS

We recognize IPSASB's goal to provide standards that are in line with International Financial Reporting Standards (IFRS). The objectives of for-profit entities do not align with taxpayer-supported public sector entities and their focus on service delivery. We are concerned that IPSASB's approach does not adequately consider the interests or needs of the public with regards to the impacts of non-exchange transactions.

The proposed views do not consider a government's legislated financial framework, which includes preparing a budget and communicating a government's accountability for actual results against that budget on a line by line basis through the financial statements. It can be difficult to directly compare asset/liability focused financial statements with revenue/expense focused budgets.

Capital Transfers

The inclusion of guidance addressing capital transfers is important. We are concerned that there is insufficient accounting guidance for transfer recipients. Determining when a liability exists can be a significant challenge. We request that an additional example (to Example 11) be provided, to illustrate the accounting for a transfer of resources where the terms of the agreement include both the acquisition / construction of an asset and its service delivery operation over a future period.

Non-exchange transactions, such as capital transfers, are usually provided to support service delivery. Sometimes the obligation to provide services is implicit. For example, a grant to build a school comes with a reasonable expectation that education programs and services will be delivered. Identifying the liability (i.e. unearned revenue) provides users with an understanding of where the funding comes from and what the present obligation of the recipient is.

The provision of capital funding to a transfer recipient enables them to deliver public services and goods to enhance or maintain the wellbeing of the public. One of the most cost-effective methods for acquiring or developing capital is for an entity with a low cost of borrowing to transfer the funds upfront or provide a forgivable loan to the entity that will own and operate the capital asset. When a capital transfer has the same characteristics as a financing transaction, e.g. a forgivable loan, financial reporting of the transaction should best align with the substance of the transfer and not the legal form of the transfer.

In our view, it is appropriate for a proportion of revenue to be recognized when the following specified activities are required of the recipient:

- The transfer recipient is expected to continually maintain or support the capital asset acquired and deliver service under the terms of the arrangement; or
- the transfer recipient provides the transfer provider with access to a specific good or service under the terms of the binding arrangement.

If the transfer recipient is required to recognize revenue in full when a tangible capital asset is acquired, this may artificially constrain cash for entities operating in a legislated balanced budget framework.

Disclosures

We agree that users of financial statements should understand the nature, amount, timing and uncertainty of revenue and cash flows. However, in some instances the level of detail proposed in the exposure draft may be too specific and onerous to collect for summary level financial statements. We caution against excessive detail in government summary financial statements, which are intended for the broad use of the legislature and the public.

Responses to specific questions posed in the exposure draft and other comments are attached. Should IPSAB have any comments or questions, please contact me at: 250-387-6692 or via e-mail: Carl.Fischer@gov.bc.ca, or Diane Lianga, Executive Director, Financial Reporting and Advisory Services Branch, at 778-698-5428 or by e-mail: Diane.Lianga@gov.bc.ca.

On behalf of the Government of British Columbia,

Sincerely,

Carl Fischer, CPA, CGA
Comptroller General
Province of British Columbia

Encl.

cc: Michael Pickup, FCPA, FCA
Auditor General
Province of British Columbia

Diane Lianga, Executive Director
Financial Reporting and Advisory Services
Office of the Comptroller General

Specific Matter for Comment 1: (Paragraphs 14-21)

The ED proposes that a present obligation is a binding obligation (legally or by equivalent means), which an entity has little or no realistic alternative to avoid and which results in an outflow of resources. The IPSASB decided that to help ascertain whether a transfer recipient has a present obligation, consideration is given to whether the transfer recipient has an obligation to perform a specified activity or incur eligible expenditure.

Do you agree with the IPSASB's proposals that for the purposes of this [draft] Standard, Revenue without Performance Obligations, a specified activity and eligible expenditure give rise to present obligations? Are there other examples of present obligations that would be useful to include in the [draft] Standard?

Yes, we agree. The substance of the transaction should determine whether a liability exists for a transfer recipient, consistent with principles-based accounting. If standards prescribe additional conditions under which the elements of financial statements exist, they may inadvertently preclude the recognition of other items that do meet the asset or liability definition. Indicators (such as the presence of specified activities, expenditure requirements, or other stipulations) are helpful to the statement preparers and should be included, but not required.

As included in the IPSASB's Conceptual Framework definition of an asset, para. 5.8, "service potential is the capacity to provide services that contribute to achieving the entity's objectives." Consideration should be given to how this concept may apply to the definition of a liability and how it may give rise to a present obligation.

Specific Matter for Comment 2: (Paragraph 31)

The flowchart that follows paragraph 31 of this [draft] Standard illustrates the process a transfer recipient undertakes to determine whether revenue arises and, if so, the relevant paragraphs to apply for such revenue recognition. Do you agree that the flowchart clearly illustrates the process? If not, what clarification is necessary?

The flowchart clearly illustrates the process. However, to be consistent with a principles-based approach we do not think that the specific conditions giving rise to a liability should be prescribed.

Specific Matter for Comment 3: (Paragraph 57-58)

The IPSASB decided that a transfer recipient recognizes revenue without performance obligations but with present obligations when (or as) the transfer recipient satisfies the present obligation.

Do you agree that sufficient guidance exists in this [draft] Standard to determine when a present obligation is satisfied and when revenue should be recognized? For example, point in time or over time. If not, what further guidance is necessary to enhance clarity of the principle?

We are encouraged by the inclusion of guidance addressing capital transfers; however, we are concerned that there is insufficient accounting guidance for transfer recipients. We request that an additional example (to Example 11) be provided, to illustrate the accounting for a transfer of resources where the terms of the agreement include both the acquisition / construction of an asset and its operation over a future period.

We believe that the substance of the transaction should determine when the liability is reduced and revenue is recognized, consistent with a principles-based approach. Indicators are helpful to the statement preparers and should be included but should not prescribe the conditions to be applied.

Specific Matter for Comment 4: (Paragraphs 80-81)

The IPSASB decided that the objective when allocating the transaction price is for a transfer recipient to allocate the transaction price to each present obligation in the arrangement so that it depicts the amount to which the transfer recipient expects to be entitled in satisfying the present obligation. The amount of revenue recognized is a proportionate amount of the resource inflow recognized as an asset, based on the estimated percentage of the total enforceable obligations satisfied.

Do you agree sufficient guidance exists in this [draft] Standard to identify and determine how to allocate the transaction price between different present obligations? If not, what further guidance is necessary to enhance clarity of the principle?

It is our view that the substance of the transaction should determine the allocation of revenue to each present obligation, consistent with a principles-based approach. We agree that the revenue recognized should be based on an estimate of the obligations satisfied.

Specific Matter for Comment 5: (Paragraphs 84-85)

Do you agree with the IPSASB's proposals that receivables within the scope of this [draft] Standard should be subsequently measured in accordance with the requirements of IPSAS 41, Financial Instruments? If not, how do you propose receivables be accounted for?

We think that transfers and taxes receivable should be subsequently measured at amortized cost (IPSAS 41.40), less an allowance for doubtful accounts. It is unlikely that a government would remeasure these at fair value on each subsequent financial statement date.

Specific Matter for Comment 6: (Paragraphs 126-154)

The disclosure requirements proposed by the IPSASB for revenue transactions without performance obligations are intended to provide users with information useful for decision making, and to demonstrate the accountability of the transfer recipient for the resources entrusted to it.

Do you agree the disclosure requirements in this [draft] Standard provide users with sufficient, reliable and relevant information about revenue transactions without performance obligations? In particular, (i) what disclosures are relevant; (ii) what disclosures are not relevant; and (iii) what other disclosures, if any, should be required?

We think that there should be mandatory disclosure of the amounts of revenue and deferred revenue, separated by major classes, and the related significant accounting policies. Disclosures of related details should be based on the significance to and the judgement of the statement preparers. Specifically, it should be left to the judgement of the statement preparer to decide how much the users benefit from the distinction between revenue with or without performance and/or present obligations.

We caution against excessive detail in government summary financial statements, which are intended for the broad use of the legislature and the public. Much of the information provided by the proposed disclosures would be more in the nature of management performance information than it would be for general purpose financial statements.

Specific Matter for Comment 7: (Paragraphs N/A)

Although much of the material in this [draft] Standard has been taken from IPSAS 23, Revenue from Non- Exchange Transactions (Taxes and Transfers), the IPSASB decided that the ED should establish broad principles for the recognition of revenue from transactions without performance obligations, and provide guidance on the application of those principles to the major sources of revenue for governments and other public sector entities. The way in which these broad principles and guidance have been set out in the ED are consistent with that of [draft] IPSAS [X] (ED 72), Transfer Expenses.

Do you agree with the approach taken in the ED and that the structure and broad principles and guidance are logically set out? If not, what improvements can be made?

The proposed standards are logically set out. However, the various types of revenue and expense are scattered around IPSAS. It would be helpful for the preparer community to be provided with a comprehensive listing of all types and where they are accounted for in IPSAS.

Other Comments

Subsequent measurement of liabilities omitted

- Per IPSAS 41, financial instruments (BC8, BC9), liabilities arising from revenue without performance obligations could fall under IPSAS 41 for subsequent measurement if they met the definition of a financial liability on the reporting date. We are not sure why this is not included in the Exposure Draft, or at least in the Application Guidance. Subsequent measurement of assets is included in paragraphs 84 and 85.
- To add clarity for the proposed standard and its relationship with IPSAS 41, we suggest revising the two related paragraphs so that they include both:
  - Assets and liabilities on initial recognition
  - Subsequent measurement of assets and liabilities

The treatment of hybrid transactions should not be prescribed

- We think that if it is not possible to distinguish between the components of a binding arrangement with performance obligations and the components without performance obligations, the transaction should be accounted for in accordance with the standard that the preponderance of evidence indicates. Paragraph 9 requires that all transactions in this situation must be accounted for under ED 70: however, if the preponderance of evidence indicates that it is more in the nature of a transaction without performance obligations it should be accounted for under ED 71.

Agreements made subject to appropriation are not binding

- We do not think that it should be possible for a transfer recipient to establish an enforceable right to a transfer from a sovereign government that is subject to appropriation (re para 36 – 37). Until an appropriation is authorized, a transferring government has not lost discretion over making payment.

The wording relating to present obligations and liabilities is not clear

- Paragraph 47 says that a present obligation "may give rise to a liability," and combined with paragraph 49 it would say "a transfer recipient shall recognize a liability only when it has a present obligation…which may give rise to a liability." Paragraph 49 should be revised to say, "only when it has a present obligation <u>that meets the definition of a liability</u>."

Missing word

- Paragraph 53 is missing the word "and" from before "…is recognized as an asset," (or is missing the word "that" from before "…arises).

Please provide examples of significant financing components in binding arrangements

- Examples would provide context and clarity to the proposed standards (para. 72 – 77), as this is a potentially complex area. Most of the time, grant recipients need the grants because they don't have money: they would be unable to finance any transaction with the grantor. And, once grants are authorized, they are generally paid; it is unlikely that the recipient would be in a situation to accrue interest revenue on unpaid grants receivable.

Who has ownership of net assets "in the event of the government being wound up"?

- While we generally agree with the accounting for taxation in this standard, we suggest a case could be made that the taxpayers of the jurisdiction would have the best claim to the net assets (re para. 92) in the unlikely event a government was wound up. Perhaps this paragraph is better suited to commercial enterprises, which are far more likely to be "wound up" than governments are.

The adoption date is not specified

- Inclusion of a planned date for adoption might encourage stakeholders to engage with the process (re para. 155).

Symmetry of accounting between parties to a transaction should not be required

- Given that symmetry is not required between the transferor and recipient for revenue without performance obligations, we do not think that the transfer provider needs to be able to confirm that expenditures are eligible (re AG26). While it is more of an issue for Exposure Draft 72, we continue to note here that symmetrical accounting between unrelated entities is not found in the conceptual framework and should not be required in accounting standards. It could to lead to poor financial management if governments are creating or modifying binding agreements so that they fit accounting requirements.