01 November 2020

BOTSWANA INSTITUTE OF CHARTERED ACCOUNTANTS COMMENT LETTER TO EXPOSURE DRAFT 71 – REVENUE WITHOUT PERFORMANCE OBLIGATIONS

Introduction

The Botswana Institute of Chartered Accountants ("BICA") is a statutory body established by Accountants Act, 2010 for the regulation of the accountancy profession in Botswana. The BICA mission is to protect public interest through promoting the accountancy profession, supporting accountants, facilitating quality professional accountancy services through the monitoring and regulation of professional accountants.

The Institute appreciates the opportunity to contribute towards IPSASB's Exposure Draft, 71 – Revenue Without Performance Obligations. We provide our comments to each specific question as per the exposure draft.

Should you wish to have further engagements please do not hesitate to contact the undersigned.

Yours Faithfully

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RESPONSES TO SPECIFIC QUESTIONS

1.0. Specific Matter for Comment 1

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?

Points to consider in making the decision

To determine if the above is acceptable we will need to evaluate the contents of paragraphs 14 – 21 as below.

Present Obligation Para 14 – 17

Five key issues arise from these paragraphs in understanding what a present obligation is namely

a) It must be binding to the parties (transfer provider and transfer recipient)
b) That the transfer provider imposes on the transfer recipient terms on the use of the assets transferred
c) The transfer recipient can do nothing to avoid undertaking the obligation
d) Its resultant is an outflow of resources to the transfer recipient
e) The binding arrangement creates a liability on the part of the transfer recipient

Specified Activity Para 18 – 19

These two paragraphs identify a specified activity as a specific action

a) imposed by the transfer provider on the transfer recipient
b) failure to perform the specific action would lead to either return of the resources to the transfer provider or incurring another form of redress.

Eligible Expenditure Para 20 – 21

From these two paragraphs it's clear that eligible expenditure are expenses that a transfer recipient is authorized to incur

a) Even though no specified activity is stated and
b) Transfer recipient accepts to use the transfer as directed.

Recommendations

Using the five key factors identified above we can evaluate whether a specified activity and eligible expenditure do meet the criteria for a present obligation by answering the following set of questions.

Does a specified activity and eligible expenditure?

a) Have a binding effect between the parties? The answer is yes
b) Been imposed upon the transfer recipient by the transfer provider? The answer is yes
c) Does the transfer recipient can do nothing to avoid either the activity or the expenditure? The answer is yes
d) Does the arrangement therefore lead to an outflow of cash for the transfer recipient? The answer is yes
e) Does the arrangement create a liability for the transfer recipient? The answer is yes

In view of the foregoing we do agree with the IPSASBs view that a specified activity and eligible expenditure do create a present obligation.

In our view providing additional examples may not be necessary and neither will it enhance any clarifications to the users of the standard.

2.0. Specific Matter for Comment 2

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?

<u>*Points to consider in making the decision*</u>

The flowchart is based on the 6-step revenue recognition model adopted by the standard as shown below.

1) Is there an asset that can be recognized?
2) Does the inflow result from a contribution from owners?
3) Does the transaction arise from a binding arrangement?
4) Are there performance obligations?
5) Are there other present obligations?
6) Recognize revenue when (or as) present obligations are met

Recommendations

By using a decision tree, each stage of the 6 step becomes a reflecting point leading to the next question or to an exit point. This therefore enables the users of the standard to determine whether to recognize an asset/revenue, asset/liability or merely make a disclosure. We therefore do concur with the IPSASB that the flowchart clearly illustrates the process.

3.0. Specific Matter for Comment 3

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?

<u>Points to consider in making the decision</u>

In SMC 1 the question of how to determine the existence of a present obligation was answered. What needs to be determined is whether there is sufficient guidance as to when and how the present obligation gets satisfied to enable the preparers of AFS to recognize revenue.

Paragraph 57 explains how to determine when a present obligation is satisfied and provides 2 key elements being

a) As the specified activities are being undertaken
b) When there are no further enforceable duties or acts to be performed

Paragraph 58 then explains that performance of specified activities or reaching the point where no further enforceable duties or acts to be performed can either be

a) Instantaneous
b) Over a duration of time

Paras 57 – 58 are clear on how to determine when a present obligation is satisfied and whether the specified activities are taken instantaneous or over time.

No illustrative Example is provided that would indicate the different circumstances that would arise due to the aforementioned.

Recommendations

The IPSASB should considered providing IEs that would clarify the concepts of instantaneous satisfaction and over a duration of time satisfaction of a specified activity

4.0. Specific Matter for Comment 4

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?

Points to consider in making the decision

Para 80 states the objective of allocating the transaction price is to ensure that each present obligation is allocated an amount that depicts the amount of inflow to which the transfer recipient expects to be entitled in satisfying the present obligations whereas Para 81 states to achieve the allocation objective the amount of revenue recognized shall be a proportionate amount of the resource inflow recognized as an asset, based on the estimated percentage of the total enforceable obligations satisfied.

Para 60 – 71 explains how to determine the transaction price and the factors that affect the process being the nature, timing and amount of the inflow taking into consideration the following

a) Variable inflows
b) Constraining estimates of variable inflows
c) The existence of a significant financing component in the arrangement and
d) Non-cash consideration

AG33 further clarifies that a transfer recipient should not recognize revenue if they believe that it is not highly probable that a significant reversal in the revenue amount will not occur. The AG further requires that an assessment be carried at the end of every reporting period on the amounts for which a transfer recipient is entitled to determine whether the threshold for measurement has been achieved.

Recommendations

The process of determining and allocating transaction price can be quite subjective and fraught with errors. In view of this it would be wise for the IPSASB to consider providing IEs that would clarify the process.

5.0. Specific Matter for Comment 5

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?

Points to consider in making the decision

Except where management opts to initially designate a financial asset as measured at fair value through surplus or deficit IPSAS 41 requires financial assets to be measured either at amortised costs or at fair value through net assets/equity based on the

a) Entity's management model for financial assets and
b) contractual cash flow characteristics of the financial asset.

A financial asset will be measured at amortised costs if

a) It's held within a management model whose objective is to hold financial assets in order to collect contractual cash flows and
b) It's contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A financial asset will be measured at fair value through net assets/equity if

a) It's held within a management model whose objective is achieved by both collecting contractual cash flows and selling financial assets and
b) It's contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Para 84 notes that receivables arising from this ED 71 will be subsequently measured as a financial asset

a) At either fair value through net assets/equity or at amortised costs in accordance to IPSAS 41 or
b) If not in scope of IPSAS 41 but meets the requirements, then it shall be measured at amortised cost
c) Para 85 goes on to state that where the financial asset does not meet the requirements of para 40 of IPSAS 41 then it shall be subsequently measured at fair value through surplus or deficit.

Recommendations

While we concur with the proposals made by IPSASB it would be advisable that an IE for receivables that are outside the scope of IPSAS 41 be given further distinguishing those that meet the requirements of para 40 of IPSAS 41 and those that don't meet the requirements.

6.0. Specific Matter for Comment 6

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?

Points to consider in making the decision

The disclosure requirement in ED 71 are in para 126 – 154 with the key areas highlighted below

Para 131 – 139 requires the disclosure of the amounts of

a) revenue from transactions without performance obligations recognized during the period by major classes

b) receivables recognized at reporting date in respect of revenue without performance obligations;
c) liabilities recognized at reporting date in respect of transferred assets subject to present obligations;
d) liabilities recognized at reporting date in respect of concessionary loans that are subject to requirements on transferred assets;
e) and existence of any advance receipts in respect of transactions without performance obligations; and
f) any liabilities forgiven
g) accounting policies adopted for the recognition of revenue from transactions without performance obligations
h) for major classes of revenue from transactions without performance obligations, the basis on which the transaction price of inflowing resources was measured;
i) For major classes of taxation revenue and revenue from other compulsory contributions and levies that the transfer recipient cannot measure reliably during the period in which the taxable event or equivalent event for other compulsory contributions and levies occurs, information about the nature of the tax, or other compulsory contribution or levy;
j) the nature and type of major classes of bequests, gifts, and donations, showing separately major classes of goods in-kind received; and
k) Qualitative and quantitative information about services in-kind that have been recognized

Para 140 – 150 requires disclosure of qualitative and quantitative information by the transfer recipient about all its binding arrangements with present obligations.

Para 151 – 154 requires the disclosure of all the significant judgments, and changes in the judgments, made in applying ED 71 to those binding arrangements.

Recommendations

We agree with the IPSASB that the disclosure requirements in this ED will provide users with sufficient, reliable, and relevant information about revenue transactions without performance obligations. We recommend however that disclosures should be considered for relevance and practicality in a public sector set-up.

7.0. Specific Matter for Comment 7

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?

Points to consider in making the decision

It would be important to review the broad principles for the recognition of revenue from transactions without performance obligations that have been established, consider if a different approach would have been viable and if so which would be the best between the alternatives.

The model starts by determining if there is any asset to be recognized, if so was it as a result of contributions by owners, if not was it due to a binding arrangement, if so are there any performance obligation, if not are there present obligations, if yes then recognize an assets and revenue/liability when the transfer recipient has control of the resources.

A comparison of this model with that adopted in ED 72 Transfer expenses appears to create a consistence in the process flow in that ED 72 model seeks to determine which transfer expenses would be considered as having a performance obligation and which would have no performance obligations.

To achieve this the ED sets off by determining two key decisions namely whether there is a binding arrangement between the transfer provider and recipient and if the binding arrangement has any performance obligations. In these decision points where the response is in the negative such expenses will be treated as transfer expenses without performance obligations and where the response is in the affirmative, they would be treated as transfer expenses with performance obligations.

Recommendations

We agree with the IPSASB on the approach taken in ED 71 and also further concur that the structure and broad principles and guidance provided are logically set out therefore no further improvements are suggested.