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Ross Smith
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International Public Sector Accounting Standards Board
International Federation of Accountants
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Dear Mr. Smith:

SUBJECT: Exposure Draft (ED) 71: *Revenue without Performance Obligations*

Thank you for the opportunity to comment on the Exposure Draft (ED) 71: *Revenue without Performance Obligations* issued in February 2020.

The Government of Canada bases its accounting policies on the accounting standards issued by the Public Sector Accounting Board (PSAB) of the Chartered Professional Accountants of Canada (CPA Canada). The Government of Canada is not required to follow the International Public Sector Accounting Standards (IPSAS), however, IPSAS are regarded as an important secondary source of generally accepted accounting principles.

Our responses to the specific matters for comment on ED 71 are included in the attached appendix.

We thank you again for providing the opportunity to comment on this Exposure Draft. If you require further information, please do not hesitate to contact either Blair Kennedy at blair.kennedy@tbs-sct.gc.ca (613-404-2996) or myself at diane.peressini@tbs-sct.gc.ca (613-369-3107).

Yours sincerely,

Diane Peressini
Executive Director,
Government Accounting Policy and Reporting

c.c.: Roch Huppé, Comptroller General of Canada
Roger Ermuth, Assistant Comptroller General, Financial Management

Canada

APPENDIX

Responses to Specific Matters for Comment

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?

Response:
We agree that a present obligation can arise under a binding arrangement (as defined in ED 70 and as noted in ED 71.AG10) when the entity is required to perform a specified activity or incur an eligible expenditure related to the resources provided, subject to our comments on SMC 3. In the case of the entity performing a specified activity, there must be an associated outflow of resources from the entity for the obligation to meet the definition of a liability.

We believe that paragraph .14 of the ED requires clarification, as it implies that all present obligations are legally (or equivalent) binding obligations. This is inconsistent with paragraph 5.15 of the *Conceptual Framework* which states that a present obligation may be legally or non–legally binding. However, we agree that, in the context of this ED, such present obligations should be limited to those that are legally (or equivalent) binding.

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?*

Response:
We generally agree that the flowchart clearly illustrates the process for revenue recognition. However, the following changes would be helpful:

- For additional clarity, the flowchart boxes referring to "other present obligations" instead refer to "present obligations other than performance obligations".
- Reflect the guidance in paragraph .50, which states that, when an advance payment is received prior to both parties agreeing to the terms of the binding arrangement, a liability is recognized rather than revenue.

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?

Response:

We do not agree that sufficient guidance exists in ED 71 to determine when a present obligation is satisfied and revenue should be recognized.

ED 70 provides a significant amount of guidance for entities to determine whether there are specific, distinct performance obligations in a binding arrangement (Step 2), and when these are satisfied and revenue recognized (Step 5). In contrast, ED 71 provides little guidance with respect to determining whether present obligations are specific and distinct, and whether they are satisfied over time or at a point in time. Under both EDs, the key to the timing of revenue recognition is whether a liability for an outflow of resources related to the present obligation exists when the resources are received from the purchaser or transfer provider.

If the terms of the arrangement are not sufficiently specific or distinct, it is questionable whether a present obligation related to incurring eligible expenditures or completing certain activities should result in recognition of a liability. For example, if the transfer terms state that a recipient must use the resources in a manner that essentially represents a continuation of the entity's mandate (e.g. resources are transferred to a public health entity to provide ongoing health services), we believe that the requirement is non-specific and, therefore, should not result in recognition of a liability. ED 71 does not provide sufficient guidance on the specificity of the terms of the transfer.

In our opinion, the approach in ED 70 for Step 2 *Identifying the Performance Obligations* (ED 70.21-29) and Step 5 *Satisfaction of Performance Obligations* (ED 70.30-.44), should be mirrored in ED 71 to the extent appropriate. Otherwise, it is likely that entities will have to analogize their transactions to ED 70 for present obligations that are not performance obligations.

Additional comments:

- We believe that paragraphs .42 and.43 are misplaced under the heading "Subsequent Consideration of Asset Recognition Criteria". These paragraphs do not relate to whether the transfer recipient should continue to recognize an asset, given that the resources have already been received, but to whether the recipient should recognize unearned revenue (credit side of the entry).
- The first sentence in paragraph .55 refers to recognition of revenue for a transaction without either performance obligations or present obligations, and therefore is misplaced in this section of the ED, which provides guidance for revenue with present obligations.
- Paragraph .57 should be amended to include a reference to eligible expenditures as follows: "A present obligation is satisfied when the transfer recipient undertakes the specified activities **and/or incurs eligible expenditures…"**

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?

Response:
We do not agree that there is sufficient guidance in allocating the transaction price between different present obligations:

- The entity must be able to identify specific and distinct present obligations at inception of the arrangement in order to allocate the transaction price. As noted in our response to SMC 3 above, there is insufficient guidance on this requirement in the ED.
- We believe that there may be arrangements where the allocation of the transaction price should relate to the outflow of resources required to satisfy each present obligation, for example when there is a requirement to return funds that are not required. Consequently, the allocation of the transaction price based on the estimated percentage of the total enforceable obligations satisfied may not be appropriate in all circumstances. We suggest that the guidance in ED 70 with respect to alternative methods of allocating the transaction price is considered.
- We suggest that additional guidance is required regarding the allocation of the cash flows under arrangements that include both present obligations and other resource inflows

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?

Response:
We agree that receivables within the scope of ED 71 should be subsequently measured in accordance with IPSAS 41 as they meet the definition of financial instruments. As well, we agree that these requirements should also be applied to receivables arising under binding arrangements that are not in the scope of IPSAS 41.

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?

Response:
We are concerned about the extent of the disclosures proposed given the resulting complexity in record keeping and reporting. Although the proposed disclosures are based on those in IFRS 15, the IPSASB may want to consider whether public sector disclosures should be less than those in the private sector given the extent of other types of reporting by governments outside of financial statements. Extensive disclosure requirements can significantly expand the financial statements with too much detailed information, thereby impairing their understandability and obscuring the most relevant information.

Consideration should be given to combining paragraphs 137 and 147 as they both address situations where the revenue may not be collectible.

Paragraphs 152 and 153 addresses disclosures related to determining the timing of satisfaction of present obligations. However, as noted above, we find there is insufficient guidance in the proposed standard to determine the timing of recognition of revenue with present obligations.

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?

Response:
In our opinion, a more logical structure would be to completely separate the requirements for recognition, measurement, presentation and disclosure for revenue with present obligations from other revenue in the scope of the standard. Otherwise, we find that requirements for other revenues, such as tax revenues, are difficult to locate.

Other comments:
Appropriations: As noted in our response to ED 72, SMC 8, with respect to whether the subject to appropriations clause in an agreement has substance, we do not agree that entering into a binding arrangement (paragraph AG 30(b)) is the trigger for the recipient to recognize an enforceable right to future transfers. In our opinion, only when a recipient has acted under the agreement with a valid expectation of receiving the future transfers would the recipient having an enforceable right to the transfer and, therefore, consider that the subject to appropriations clause does not have substance. Please see our response to ED 72 for more detailed considerations.