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Public Sector Accounting Board

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International Public Sector Accounting Standards Board (IPSASB)
277 Wellington Street West
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Re: Response to Exposure Draft 71, *Revenue without Performance Obligations*

Thank you for the opportunity to provide input on a future International Public Sector Accounting Standard on revenue without performance obligations.

Overall PSAB staff are supportive of the proposals in [draft] IPSAS (ED 71), *Revenue without Performance Obligations* but believe additional context and guidance would be helpful.

PSAB staff believe that additional context and guidance would be helpful to ensure consistent interpretation and application of the proposals. Specifically, describing how transactions without performance obligations may include present obligations that are not performance obligations is a key distinction between [draft] IPSAS (ED 70), *Revenue with Performance Obligations* and [draft] IPSAS (ED 71), *Revenue without Performance Obligations*. Articulating this upfront will provide context for the proposals in ED 71 and help readers apply the appropriate Standard given their circumstances. As noted in the video regarding ED 71, *Revenue without Performance Obligations*, an understanding of the difference between a performance obligation and a present obligation is needed to determine which transactions are within the scope of which Exposure Draft and then understand the proposals to be applied.

Furthermore, additional guidance is needed:

- indicating that an assessment of each transaction should be undertaken at inception to determine if it includes one or more present obligations and that each distinct present obligation should be accounted for separately. This will help determine when those present obligations are satisfied, which may impact the timing of revenue recognition.
- to help determine when revenue would be recognized over time and how to allocate the transaction price to multiple present obligations.

Providing this additional guidance will result in a more comprehensive standard and aid consistent application of the standard.

The comments set out in this letter and the appendices represent the views of PSAB staff, not those of the Public Sector Accounting Board (PSAB). The appendices include:

- **Appendix A**: Responses to Specific Matters for Comment
- **Appendix B**: Other Issues

We hope that you find the comments helpful.

Kind regards,

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APPENDIX A – RESPONSES TO SPECIFIC MATTERS FOR COMMENT

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?

PSAB Staff Response

PSAB staff agree that, for purposes of this Standard, a specified activity and/or eligible expenditure provide evidence that there is a present obligation.

However, to help clarify how a specified activity differs from an eligible expenditure, references should be provided to the Application Guidance where an example of each is provided (paragraphs AG 25-26 for eligible expenditure and AG 27 for specified activity). The guidance found in the application guidance should also be referenced back to the specific paragraphs in the [draft] standard.

In addition, adding an example of an eligible expenditure within paragraph 20, similar to that done for a specified activity in paragraph 18 might be helpful.

Furthermore, additional guidance would be helpful to demonstrate the need to clearly identify the specified activities and/or eligible expenditures. In order to determine when a present obligation is satisfied, at inception of the transaction, the specified activities and/or eligible expenditures must be identified. The specificity of the specified activities and/or eligible expenditures outlined in a binding arrangement will help determine the present obligations. Providing guidance on the need for specificity of these items would be helpful to determine when and how the present obligations will be satisfied.

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?

PSAB Staff Response

PSAB staff agree the flowchart illustrates the process. As noted in paragraph 4, "This [draft] Standard addresses revenue arising from transactions without performance obligations. This includes transactions arising from binding arrangements and those not arising from a binding arrangement…."

The flowchart illustrates that a transaction with a binding arrangement may have present obligations or not. When there is a binding arrangement but no present obligations, an asset is recognized (paragraph 33) and revenue is recognized (paragraph 86).

The flowchart also illustrates that when a transaction does not arise from a binding arrangement, an asset is recognized (paragraph 33) and revenue is recognized (paragraph 86).

Paragraph 86 provides the revenue recognition principle for Transfers without Present Obligations. However, there is no further mention that this principle also pertains to transactions with no binding arrangements. Consider amending the label/heading "Transfers without Present Obligations" to Transactions arising without a Binding Arrangement and/or Transfers without Present Obligations". This would align with the flowchart.

Paragraph 86 wording could be amended to reflect both scenarios that would give rise to immediate recognition of revenue.

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?

PSAB Staff Response

No – PSAB staff do not agree. Although the principle in paragraph 54 clearly states that revenue should be recognized when (or as) a present obligation is satisfied, clarifications and additional guidance would be helpful to determine or illustrate:

- that transfers may have multiple present obligations and the importance of identifying and accounting for each present obligation separately; and
- how satisfying present obligations may be over a period of time or at a point in time.

Paragraph 55

- The first sentence of paragraph 55 (When transfer recipient recognizes an increase in net assets as a result of a transaction without performance obligations and there are no present obligations, it recognizes revenue.) is not addressing transactions without performance obligations but with present obligations. Therefore, it should be removed from this section to avoid confusion and included under the section heading Transfers without Present Obligations.

Multiple present obligations

- The first clear indication that there may be transfers with multiple present obligations is in the measurement of revenue principle (paragraph 59). The only other specific guidance related to multiple present obligations is provided in the section Allocating the Transaction Price to Present Obligations (paragraphs 80-81).
- Some guidance upfront in the recognition of present obligations would be helpful to indicate that multiple present obligations are possible and need to be identified at the inception of the transaction. This would provide clarity and helpful context for the remaining guidance. For example, guidance such as,
    - A public sector entity would need to identify each distinct present obligation at inception of the transaction. When more than one specified activity and/or eligible expenditure is to be undertaken, a public sector entity would determine whether they are distinct and should be accounted for separately.

      Accounting for each distinct present obligation will help a public sector entity determine when it has satisfied a present obligation, which may impact the timing of revenue recognition.
    - Guidance found in [draft] IPSAS (ED 70), *Revenue with Performance Obligations*, under Step 2: Identifying Performance Obligations could be leveraged to develop guidance for identifying present obligations in transactions without performance obligations. Consider including this guidance or context after paragraph 52.

Satisfying present obligations

- The guidance provided in paragraphs 57 and 58 to address satisfying present obligations is very general. It does not provide any guidance on how to determine when revenue would be recognized over time versus at a point in time.
- Paragraph 57 notes that "… A present obligation is satisfied when (or as) the transfer recipient undertakes the specified activities and has no further enforceable duties or acts to perform." Consider adding "and/or eligible expenditures" after 'specified activities'. As noted in paragraph 17, "The transfer recipient considers whether an obligation to perform a specified activity or incur an eligible expenditure is a present obligation." Present obligations in a binding arrangement can arise from either specified activities and/or eligible expenditures so it is important to consider both scenarios.
- Consider whether the criteria for satisfying performance obligations in [draft] IPSAS (ED 70), *Revenue with Performance Obligations* could be leveraged to provide some

guidance on when it would be appropriate for present obligations to be satisfied over time. Also consider leveraging the guidance found in paragraphs 38-44 of [draft] IPSAS (ED 70), measuring progress towards complete satisfaction of performance obligations, for a section to address measuring progress towards complete satisfaction of present obligations. This may be useful for public sector entities in determining the revenue to be recognized over time as a result of undertaking its specified activities and /or incurring eligible expenditures.

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?

PSAB Staff Response

No, PSAB staff do not agree. We feel additional guidance would be helpful. Depending on the terms of the binding arrangement, it may not be clear, when there are multiple present obligations, how much of the transaction price should be allocated to each present obligation. Therefore, guidance should be provided for estimating those allocations. The guidance found in [draft] IPSAS (ED 70), *Revenue with Performance Obligations* for allocating the transaction price could be leveraged. For example, the expected cost approach for estimating the stand-alone price of a good or service could be leveraged and used as guidance to support how to allocate the transaction price to each present obligation. Consideration as to whether the other two methods (adjusted market assessment approach and residual approach) would be relevant for specified activities and/or eligible expenditures is needed.

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?

PSAB Staff Response

This seems like a reasonable approach.

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?

PSAB Staff Response

The disclosures are quite extensive. They seem to include similar disclosure requirements as those outlined in [draft] IPSAS (ED 70) as well as additional disclosure requirements to address transactions without present obligations and/or without a binding arrangement.

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. Although this is important information, there is not adequate guidance within the standard itself to determine what methods could be used to recognize revenue and how the methods provide a faithful depiction of the transfer of goods or services.

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?

PSAB Staff Response

Yes. However, more context would be helpful to fully understand the nature of the transactions being contemplated by the proposals. A clear explanation upfront in the objective section of the standard regarding the distinction between a performance obligation and a present obligation would help stakeholders ensure they apply the appropriate standard and provide more context for the proposals. Understanding how transactions that fall under Revenue without

Performance Obligations may have a present obligation that is not a performance obligation is an important distinction and provides the foundation for the proposals.

It might also be helpful to provide additional context for what "revenue without performance obligations" comprises. Paragraph 4 provides some indication referencing that this will include transactions arising from binding arrangement and those not arising from binding arrangements. Paragraph 4 also provides some examples of common transactions without performance obligations. However, it would be helpful to also indicate upfront that transactions with binding arrangements may include present obligations or may not have present obligations. Again, this context upfront would set the foundation for the proposals to follow and align better with the flowchart.

Cross references between the [draft] IPSAS and Application Guidance should be consistently used to help guide users to the information.

APPENDIX B – OTHER ISSUES

1. Capital Transfers

ED Reference: Paragraphs 108-109, AG 24 IE 69-74 and BC 19-23

Issue: Clarification of guidance would be helpful.

Explanation: Paragraphs 108-109 are very general. In Canada, allowing capital grants to be recognized over the useful life of the related asset acquired with the grant is an important issue. The CPA Canada Public Sector Accounting Handbook permits the recognition of revenue over the life of the capital asset in some circumstances (GOVERNMENT TRANSFERS, Section PS 3410).

In [draft] IPSAS (ED 71), the definition of a capital transfer and the guidance in paragraph AG 24 indicates that a capital transfer is defined as a binding arrangement where a transfer provider provides cash or another asset with the specification that the transfer recipient acquires or constructs a non-financial asset. This implies that revenue could only be recognized once the non-financial asset is acquired or constructed, not over the life of the capital asset.

The illustrative examples provided in IE 69-74 and the Basis for Conclusions paragraphs BC 19-23 introduce the idea that these binding arrangements may include one or more present obligations. One of the present obligations could be for the operation of the capital asset over a period of time, as stated in the binding arrangement.

As indicated earlier, the notion that a binding arrangement may have multiple present obligations needs to be articulated clearly in the Standard. As well, the need to identify each distinct present obligation at the transaction inception is important to determine when and how each present obligation will be satisfied, which impacts the timing of revenue recognition.

Regarding capital transfers, there are three possible scenarios that may arise:

1. **Just Buy or Build:** The first scenario is where there is only one present obligation, that is the binding arrangement only addresses the acquisition or construction of the capital asset.

2. **First Buy or Build, Second - Use to Provide Services:** The second scenario is where there are two present obligations in the binding arrangement. One present obligation is for the acquisition and construction of the capital asset. A second present obligation is specified in the binding arrangement for the use of the capital asset over the life or determined period of time. No funding is provided for this second present obligation in the transaction price; it is assumed to be funded coincident with the acquisition or construction of the capital asset. In this scenario, the present obligations in the binding arrangement are dependent on each other and must be satisfied consecutively. That is, only after the first present obligation is satisfied by acquiring or constructing the capital asset, can the second present obligation to use the asset over its useful life or a determined period of time be satisfied. In this scenario, the binding arrangement indicates that the transaction price is effectively for both present obligations, but it would not be

allocated between them given their dependent and consecutive nature. The whole transaction price is first allocated to the first present obligation. The second present obligation accrues as the first obligation is satisfied.

3. **First Buy or Build, Second - Use to Provide Services, Third - Funding Included for Operating and Maintenance Costs Over Term of Service Provision:** The third scenario is the same as the second except that the binding arrangement includes a third present obligation, a requirement to use a portion of the funding for operating and maintaining the asset over the periods it is used to provide services. In this scenario, the transaction price would at inception be allocated to the first and third present obligations, distinguishing between the portion required to acquire or construct the asset and the portion required to operate and maintain it as it is used to provide services in the future. As in scenario 2, the second present obligation cannot be recognized until and as the first present obligation is satisfied. As the present obligation to acquire or construct the capital asset is satisfied, the present obligation to use the asset over its useful life or a determined period of time is being accrued. The third present obligation would be satisfied as the operation and maintenance costs for the asset are incurred.

The IPSASB may want to consider addressing these three scenarios directly in the text or as illustrative examples.

2. Hybrid Transactions

Issue: The current guidance for hybrid transactions is addressed in IPSAS 23 paragraph 41 which states, "… In determining whether a transaction has identifiable exchange and non-exchange components, professional judgment is exercised. Where it is not possible to distinguish separate exchange and non-exchange components, the transaction is treated as a non-exchange transaction."

ED Reference: Paragraph 9 of [draft] IPSAS (ED 71) notes "… Where it is not possible to distinguish between the components with performance obligations and the components without performance obligations, the transaction is accounted for in accordance with [draft] IPSAS (ED 70). [DRAFT] IPSAS (ED 70) paragraphs AG69-AG70 provide additional guidance."

[DRAFT] IPSAS (ED 70) paragraphs AG69-AG70 do not clearly address situations where it is not possible to separate the two components of the transaction.

Furthermore, directing stakeholders to [draft] IPSAS (ED 70) implies that the principles of Revenue with Performance Obligations would apply when it is not possible to distinguish the components of the transaction. This would be a change from the current requirement in IPSAS 23. Given the statement in paragraph 4, "… While revenues received by public sector entities arise from both transactions with and without performance obligations, the majority of revenue of governments and other public sector entities is typically derived from transactions without performance obligations …", it would seem logical that in circumstances where the components could not be distinguished to apply [draft] IPSAS (ED 71), Revenue without Performance Obligations.

3. Appropriations

Issue: A more comprehensive illustrative example would be useful.

ED Reference: Illustrative example 31 – Transfers subject to Authorization of Appropriations. This example is very similar to that provided in [draft] IPSAS (ED 72), *Transfer Expenses*. As noted in PSAB staff response to [draft] IPSAS (ED 72), a more complex example would be useful to demonstrate the judgment often required in practice. Also, guidance for applying substance over form in such circumstances would be helpful. As noted in the PSAB staff response to [draft] IPSAS (ED 72), consider the discussions of Canada's Public Sector Accounting Discussion Group (PSA DG) on the "authority to pay". The relevant meeting reports can be found here; we suggest searching "authority to pay": https://www.frascanada.ca/en/psab/committees/psadg/search-past-topics . This issue was discussed on September 5, 2013 and March 15, 2017.

4. Clarifications and Editorial suggestions

Issue: There are a few instances throughout the standard where greater clarity would be helpful.

ED Reference:

- Paragraph 11 notes that the definitions for:
  - a binding arrangement:
  - control of an asset;
  - a performance obligation; and
  - a third-party beneficiary

  are defined in [draft] IPSAS (ED 70). These are key terms to this [draft] IPSAS as well and should be defined within the body of the standard to make it easy for readers. Given there are only four terms, adding the definition for these critical terms within each standard would not be unreasonable and in fact would assist readers making it easier to fully understand and apply the proposals.

- Paragraph 86 states: "When a transfer recipient recognizes an inflow of resources as an asset for a transaction with no present obligation as set out in paragraphs 32-43, it recognizes revenue immediately".
  - Consider changing to: When a transfer recipient recognizes an inflow of resources as an asset for a transaction without performance obligations and without ~~no~~ present obligations as set out in paragraphs 32-43, it recognizes revenue immediately.

    - This would align the text with the title of the [draft] IPSAS and with paragraph 53. Paragraph 53 reads: "When an inflow of resources arises from a transaction without performance obligations, but with present obligations, is recognized as an asset, revenue shall also be recognized, except to the extent that a liability is recognized for any unsatisfied present obligations in respect of the same inflow."

- Paragraph 87 states: "Revenue from transactions without present obligations shall be measured at the amount of the increase in net assets recognized by the transfer recipient."
    - Consider changing to: Revenue from transactions without performance obligations and without present obligations shall be measured at the amount of the increase in net assets recognized by the transfer recipient.
    - This would align the text with the title of the [draft] IPSAS and with paragraph 59. Paragraph 59 reads: "An asset in a revenue transaction without performance obligations but with one or more present obligations shall initially be measured by the transfer recipient at its transaction price as at the date in which the criteria for asset recognition is satisfied (see paragraphs 60-79)."
- Paragraph 65 provides a description of possible reasons why the amount of an inflow might be variable. Some of the possible reasons noted are "incentives" and "performance bonuses". Wondering how relevant these examples are when considering transactions without performance obligations.
- Paragraph AG 2 outlines the core principle of the Standard. To align with the flowchart, as noted above, the description in AG 2 (b) should be amended to include transfers that arise from a binding arrangement but with no present obligations. For example, AG 2(b) could be rewritten to say:
    - For transfers that do not arise from a binding arrangement or arise from a binding arrangement but without a present obligation, revenue is recognized when the criteria for the recognition of an asset are met.
- Paragraph AG33 is confusing as it is written in the negative. Consider rewording so it is easier to understand.
- Cross references between the Standard and the Application Guidance would be helpful. For example (this is not a complete listing of where cross references would be helpful, there are many instances throughout the document):
    - Paragraphs 18-19, Specified Activity should include a reference to AG 27. Paragraph AG 27 should include a reference to paragraphs 18-19.
    - Paragraphs 20-21, Eligible Expenditure should include a reference to AG 25-26. Paragraphs AG 25-26 should include a reference to paragraphs 20-21.

  - Paragraphs 108-109, Capital Transfers should include a reference to AG 24. Paragraph AG 24 should include a reference to paragraphs 108-109.

- Illustrative examples, there are a few instances where a review of the references is needed. For example, Example 30 refers to Example 27 in paragraph IE 73, which I believe should be Example 29. Example 32, in paragraph IE 83, refers to Example 30 which I believe should be Example 31.

- Illustrative examples – Example 25, Disclosures Made in the Financial Statements of Government A. Exercise caution when providing an example of note disclosures as they often become the template.

5. Complexity of the Standard

We understand that many of the proposals in EDs 70, 71 and 72 are aligned with IFRS 15, *Revenue from Contracts with Customers*, amended as appropriate for the public sector. We are concerned with the complexity of these proposed standards and the extent of the related disclosures for smaller public sector entities. While this issue for smaller entities is not unique to these proposals, we felt the concern should be raised.