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October 27, 2020

International Public Sector Accounting Board
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Our response to Exposure Draft 71: Revenue Without Performance Obligations is below.

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?

We agree that a present obligation must be a binding obligation that the entity has little or no realistic alternative to avoid fulfilling the obligation, and that fulfilling the obligation requires the expenditure/consumption of resources. The present obligation includes the obligation to use the funds in a specified way or carry out specified actions, as well as the obligation to return funds where they are not used as specified or the required actions are not carried out.

We also agree with the concept of specified activities as the agreement and/or stipulations on a transfer may specify actions that must be carried out rather than define eligible expenditures.

We suggest the IPSASB consider expanding this to include specified outcomes. A transfer may specify an outcome that must be achieved in order to retain the funding, such as achieving an emission reduction target. The achievement of this target may represent a present obligation if actions and/or expenditures are required to achieve it. These may be distinct from specified actions or eligible expenditures if the agreement defines only what is to be achieved and is silent on how to achieve it. IPSASB may consider adopting a common term such as "stipulations" to refer to eligible expenditures, specified actions and/or specified outcomes.

We have an additional comment on Paragraph 24. The past experience or knowledge of a transfer provider never enforcing an arrangement if a breach occurs would appear difficult to apply and to audit. Would the entity need to have such direct experience? Or is this something they may hear or infer from other entities receiving transfers? Is evidence required that the transfer provider was clearly aware of the breach and clearly chose not to act? It appears that an entity might not recognize a present obligation believing that they can misuse the funds because they have done so in the past and not gotten caught. But it is not clear that such past actions would be legally binding on the transfer provider for future transfers as an entity may be free to start enforcing the obligations at any time. A better concept is that the actions and communications of the transfer provider indicate that a future breach, if it occurs, will not be enforced. The application of this may vary based on local legal systems and the presence of principles like estoppel that would prevent a transfer provider from taking the recipient to court over the breach. But, barring some clear communication or event that would bar the transfer provider from enforcing the arrangement, a recipient should recognize a liability as it cannot unilaterally avoid fulfilling the obligation in some form or other (such as correct use or return of funds). We also note that transfer provider that may recover mis-used funds by deducting them from future transfers will have greater ability to enforce terms of an agreement.

It may also be possible for the recipient to create additional or more specific obligations through their own actions and communications. For example a federal government transfer to a state level government may define eligible uses of the funds. On announcement of the transfer, the state level government may commit to use the funds for specified municipal projects. IPSASB should consider how such a communication would affect the recognition and subsequent measurement of the present obligation under a future IPSAS [X[(ED 71).

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 but may be difficult to apply where funds are received in advance that are to be governed by a subsequent binding arrangement. To apply paragraph 50, the box for applying IPSAS [X] (ED 71) should ask "Are there (or will there be) other present obligations related to the inflow? (paragraph 47-50)"

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 note that the proposed paragraph 57 refers to specified activities but not eligible expenditures. It would be more difficult to apply without full reference to what must be done to fulfill the present obligtation.

We suggest that paragraph 57 also include the concept of a specified outcome to be achieved, as discussed under Comment 1, above. As there may not be a direct relationship between funds spent/cost of activities carried out and the reduction of the obligation, entities should re-evaluate how much of the obligation remains after carrying out activities and incurring expenses under the agreement, and recognize the amount of the reduction in the obligation as revenue. For example, if the terms of the transfer require a specified reduction in emissions and require pro-rated repayment if the actual emission reductions fall short of the target – it may be appropriate to recognize half of the transfer as revenue when half of the emission reductions are achieved.

Also, BC23 recognizes that some obligations will be fulfilled over the a period of time through usage of assets and not just by expenditure of cash. We believe this is an important concept that should be included in the main body of the standard (paragraphs 57 and 58) and not just in a basis for conclusions. The definition of capital transfer should also be updated to not just include "to acquire or construct" but also "to use." Note that recognition of revenue should be based on the nature of the present obligation and how it is discharged which would typically be at a different rate than the amortization expense of the asset(s) involved. We will discuss this further in Comment 4.

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?

We believe that some transfers may not support division into separate allocated present obligations for key activities or expenditures – such as separate obligations for acquiring/constructing an asset and for using that asset in a specified way. Recognition of revenue should be driven by the reduction in liabilities. As the liability represents both the obligation to make eligible expenditures or carry out specified actions (or achieve specified outcomes) and the obligation to repay funds if the requirements of the agreement are met – revenue should not be recognized to the extent that liabilities remain.

For example, if an entity has made 75% of the eligible expenditures they would appear to have fulfilled 75% of the first part of the obligation. However, if repayment is based on thresholds of achievement and the entity would be required to repay 30% of the transfer if no further expenditures are made, only 70% of the transfer should be recognized into revenue. Revenue should not be recognized if there is a potential to be required to repay some of that portion of the transfer if further expenditures/actions are not carried out.

For capital transfers, the construction/acquisition of the capital asset may be incidental to discharging the liability.

For example:

- A transfer agreement may allow funds to be used for capital, but the capital must be fully consumed in the specified research project. The fair value of any residual capital asset must be restored to the research project for other eligible expenditures if the capital asset ceases to be used in the research project, and unspent funds must be returned to the transfer provider at the completion of the research project. In this case, revenue should be recognized as the capital asset is amortized if this is a reasonable approximation for the loss in fair value of the asset.
- A transfer agreement may require the recipient to construct a housing asset and operate it for 20 years as part of a defined housing program, with the grant to be proportionately repaid if it ceases to be operated as required. In this case, the construction of the asset is incidental and the grant would be earned at a rate of 5% for each year the asset operates in the program. This would be a different rate from the rate of amortization expense for the building.

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 support receivables being accounted for in a consistent basis within the standards based on their underlying economic substance.

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?

While the proposed requirements include the amount of liabilities at the reporting date and the amount recognized into revenue during the year, this may not be sufficient for readers to understand how the balance has changed from the previous year. We believe entities should disclose a reconciliation from the prior year liability balance, new funds received with present obligations, amount of transfers recognized into income during the year, any other changes to the liability and the reporting date liability balance.

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?

Multi-year funding:
While it is helpful that IPSASB has considered the impact of multi-year funding arrangements where future funding is subject to appropriations, the guidance could be clearer. The examples in IE75-IE82 seem to hinge on whether the commitment made by the transfer provider meets the definition of a liability – specifically, whether the transfer provider can reasonably avoid providing the remainder of the funds. AG 28-AG32 provides some guidance, but more explanation could be provided regarding the example in AG30. A reason why a future transfer would be subject to the approval of an appropriation may be because the executive branch entering into the agreement does not have authority to compel the legislative branch to pass the appropriation. It would seem that an exercise of authority described in 30(b) would have to be done in a way that removes or voids the clause in the agreement that made the transfer subject to an appropriation. Greater reference could be made to the actions and communications of the transfer provider outside of the agreement that may leave the transfer provider with little or no realistic alternative to avoid providing the remaining transfers (provide grounds for the recipient to sue to collect the promised funds from government)..

Endowments:
It would be beneficial if the standard could provide guidance for the accounting for endowments, where an entity receives funds that must be invested and not spent with income earned being restricted for a specific purpose. The endowment would appear to be an asset of the entity as it generates future benefits (income) to fund a part of the entity's operations. But it is less clear what account(s) would be credited. If the requirement to hold and not spend the contribution represents a liability, the liability would never be discharged. But if the funds are recognized as revenue the entity may show revenue and an operating surplus for funds that are not available to be spent to fund the entity's operations. The only other alternative would appear to be crediting the net assets/equity of the entity directly. Please consider guidance to resolve this uncertainty on how to account for endowments.

Services in-kind:
We disagree with paragraph 110 because recognition of services-in-kind should be required not optional, if they meet appropriate recognition criteria. This aids in transparency and comparability as the full cost of the entity's operations and sources of funding/contributions would be recognized in the financial statements.

Segmented reporting of appropriations:

IPSAS 18 Segmented Information includes grants and transfers within the definition of segment revenue. But it is not clear how appropriations would be accounted for by the segment. Would funds spent from a central government account under the spending authority of an appropriation be considered transfer revenue by the segment, or would the credit be recognized as something else such as a direct injection of net assets/equity? Guidance on how ED 71 and ED 72 might apply to appropriations for segments of a government entity may be beneficial in resolving this uncertainty.

Thank you for the opportunity to comment.

Sincerely,

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