



Office of the
Auditor General
of Canada

Bureau du
vérificateur général
du Canada

30 October 2020

International Public Sector Accounting Standards Board

International Federation of Accountants
277 Wellington Street West
Toronto, ON M5V 3H2

Re: Exposure Draft 71, *Revenue without Performance Obligations*

Thank you for the opportunity to comment on the above Exposure Draft. I am responding on behalf of the Office of the Auditor General of Canada.

We are pleased to submit to the Board our response below to the specific questions posed in the Exposure Draft.

Sincerely,

A handwritten signature in black ink, appearing to read "Lissa Lamarche".

Lissa Lamarche, CPA, CA
Assistant Auditor General

Specific questions posed by IPSASB:

Question 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 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. Based on the types of transfer payments we see in our jurisdiction, we are not aware of other examples of present obligations that should be included in the [draft] Standard.

We find, however, the distinction made in the [draft] Standard between specified activities and eligible expenditures to be somewhat confusing. We cannot think of many situations where an entity would have a specified activity without also incurring eligible expenditures and vice versa. For this reason, we think it would be clearer to combine these two concepts rather than making a distinction between the two.

Regarding specified activities and eligible expenditures, we also think more guidance is needed around the specificity of these two items. It would be useful to have guidance on how broad the specified activity or the eligible expenditure need to be and if both time and use need to be specified since specificity has caused challenges in applying the Canadian Public Sector Accounting Standard on government transfers.

Question 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?

We do not agree that the flowchart clearly illustrates the process since it does not seem to include the scenario explained in paragraph 50 of the ED.

Paragraph 50 states that "if a transfer recipient receives resources prior to both parties agreeing to the terms of the arrangement and it is expected that a binding arrangement will be entered into, it recognizes a liability for an advance receipt until such time as the arrangement becomes binding". If we are in the situation described in paragraph 50, our understanding is that at that point in time, there is not yet a binding arrangement between the two parties. As a result, when using the diagram, one would need to answer "no" to the question "does the transaction arise from a binding arrangement". If the answer is "no", based on the diagram, the recipient would record an asset and revenue. However, as per paragraph 50, if it is expected that a binding arrangement will be entered into, a liability should be recognized for an advance receipt until such time as the arrangement becomes binding. As a result, we believe that the diagram should be updated to include the scenario contemplated in paragraph 50 of the ED.

Question 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 do not agree that sufficient guidance exists in this [draft] Standard to determine when a present obligation is satisfied and when revenue should be recognized in the case where a specified activity or capital transfer have given rise to a present obligation.

ED 71, paragraph 57 states that “A transfer recipient shall recognize revenue without performance obligations when (or as) the transfer recipient satisfies the present obligation. 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”. Paragraph 58 states that “For each present obligation identified, a transfer recipient shall determine at the inception of the binding arrangement whether it satisfies the present obligation over time or satisfies the present obligation at a point in time. If the transfer recipient does not satisfy a present obligation over time, the present obligation is satisfied at a point in time”.

We note that paragraph 57 only mentions “specified activities” without also mentioning “eligible expenditures” which both give rise to a present obligation (discussed in paragraph 58). We are therefore unclear whether the reason for the omission of “eligible expenditures” in paragraph 57 is due to the fact that a transfer with eligible expenditures would be recognized over time (i.e. as eligible expenditures are incurred) as opposed to a point in time (e.g. all up front or all at the end). We think that IPSASB should clarify these paragraphs so that they address the requirements for both items that give rise to a present obligation.

In addition, we note that this ED does not provide specific guidance to help determine if a present obligation is satisfied over time or at a point in time. When eligible expenditures give rise to present obligations, determining when revenue will be recognized should be relatively straight forward since revenue will likely be recognized when or as eligible expenditures are incurred. In most cases, we expect that it will be over time for those types of binding arrangements. However, when specified activities give rise to present obligations, per paragraph 57, revenue should be recorded “when (or as) the transfer recipient undertakes the specified activities and has no further enforceable duties or acts to perform”. Examples 11 (IE 27-29) and 13 (IE 32-34) provide some elements to consider in certain specific situations. However, due to the broad nature of binding arrangements with specified activities that give rise to present obligations, we believe that further guidance on the timing of revenue recognition is needed.

To illustrate, consider the example in ED 71.IE32-IE34 which describes a transfer where the transfer recipient is required to use funds to improve and maintain mass transit systems with specific amounts to be used in three specific areas. It is unclear to us how one would determine whether the obligation is satisfied as the money is spent in each area or only once the money is fully spent. A similar example would be where a transfer recipient receives funding to construct a hospital. We are not sure if revenue recognition only occurs when the hospital has been fully constructed or if it occurs as and while the hospital is being constructed. We would recommend that the example in the [draft] Standard be expanded to provide more guidance to help conclude based on the fact pattern provided. In addition, it would also be useful to have more examples with different fact patterns to help better understand the criteria to use in forming our judgment. Without additional guidance in this area, we think there will be inconsistent application in applying this [draft] Standard.

Finally, this ED has a section on capital transfers which is an improvement from IPSAS 23 which did not specifically address capital transfers. However, similar to our above comment, we are of the view that further guidance is needed to determine when a present obligation is satisfied for these types of transfers to ensure consistent application. We note that there is information in paragraph BC22 (emphasis added) which talks about recognizing revenue as the asset is procured or constructed, but this is not discussed in the standard itself. We also note that paragraph BC23 (emphasis added) discusses the fact “that some capital transfers may include multiple present obligations, one being the procurement or construction of a capital asset and another being the operation of the capital asset in a particular way for a specified period of time”. We are of the view that the concept that a binding arrangement may have multiple present obligations should be articulated clearly in the [draft] Standard. In addition, in paragraph BC23, the notion of having one present obligation related to the operation of the capital asset is brought up for the first time and only briefly discussed there and not in the standard itself. We think the [draft] Standard would be clearer if it incorporated the fact that a binding arrangement for a capital transfer may include one or more present obligations, as well as guidance as to how each present obligation may be satisfied and revenue recognized.

Question 4 (Paragraph 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 have no comments on this Specific Matter for Comment.

Question 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 have no comments on this Specific Matter for Comment.

Question 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 have no comments on this Specific Matter for Comment.

Question 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?

We agree with the approach taken in the ED and that the structure and broad principles and guidance are logically set out with the exception that some improvements could be made to the references within the ED. We note that the [draft] Standard itself sometimes makes reference to application guidance paragraphs, but not in all cases. For example, ED 71.AG16-AG23 deals with enforceability but there is no mention of these application guidance sections in paragraphs 22-26 which deal with enforceability. We think it would enhance clarity if there were two-way references between the [draft] Standard and the application guidance section. This would help users more easily navigate and apply the [draft] Standard. Consideration could also be given in doing the same thing with the illustrative examples.

Other considerations:

Appropriations guidance:

As noted in our analysis for Specific Matter for Comment 6 and 8 in ED 72- *Transfer Expenses*, we suggest that more guidance is needed to assess substance over form in determining whether the transfer recipient has control over resources to be transferred by a transfer provider prior to the appropriation being authorized. While we are pleased to see that the IPSASB has specifically addressed appropriations in the proposed standard, this is an area that is particularly challenging for Canadian public sector entities and thus we believe that more guidance should be provided.

Specifically, the guidance and illustrative examples in this ED do not go far enough to help users sufficiently make the substance over form assessment. The illustrative examples (IE75-IE82) seem to be very black and white when in reality the situations are not always clear. We think that the IPSASB should expand the guidance as well as review and enhance the illustrative examples to include the factors to be considered when assessing substance over form.

In the Canadian Federal Government, it is customary for multi-year funding arrangements to include an appropriation clause, which typically states that future transfers under the agreement are subject to there being a Parliamentary appropriation for the fiscal year in which the payment is to be made. There has been much debate as to whether this clause has substance when the government has always paid once the recipient has met its obligations under the arrangement. One could conclude that form does not equal substance unless the government has previously not paid. One could equally conclude that form equals substance until the government has acted in a way that would lead you to conclude otherwise. The accounting treatment is very different depending on the perspective taken.

We also note that in some Canadian jurisdictions it is common for governments to fund large infrastructure projects over periods far longer than the period for which eligible expenditures might occur. For example, a government may fund an infrastructure project for the next 20 years that is subject to an annual appropriation. Eligible expenditures under the agreement occur over 5 years. The transfer provider recognizes 1/20 of the funding each year for 20 years, whereas the eligible expenditures were incurred in years 1 to 5 and it is a matter of public record that the government funded the project. When the government has always paid the transfer recipient under these large infrastructure projects, it is a matter of public record that the government has provided funding for the project, and the eligible expenditures have already been incurred, these circumstances may be an indication that the government has lost control of the transfer and thus the appropriation clause has no substance.

We think that the IPSASB should further explore these and similar situations in order to develop some helpful criteria for assessing whether appropriation clauses in binding arrangements have substance or not. As noted in our analysis for Specific Matter for Comment 6 and 8 in ED 72-*Transfer Expenses*, without such additional guidance on assessing substance over form, the principles will be difficult to apply consistently in practice.

Scope of the [draft] Standard:

We see a lack of clarity with paragraph 5 that states that “Revenue transactions without performance obligations are transactions where there is no requirement for a transfer recipient to transfer any goods or services to a transfer provider or a third-party beneficiary. Transactions within the scope of this [draft] Standard differ from those within the scope of [draft] IPSAS [X] (ED 70) where a performance obligation does require a transfer of goods, services or other assets to either the purchaser (transfer provider) or a third-party beneficiary”. ED 70 refers to goods or services and they may encompass non-current assets, but it is not clear if it could include cash. Therefore, it is not clear to us under which of the two standards (ED 70 or ED 71) a scenario where a Government provides funding to an entity that provides cash benefits to third-party beneficiaries under a government program, other than a social benefit program, would fall. We suggest that it should be more clearly articulated in the scope section of ED 70 and ED 71.

Other editorial comments:

In AG16, there seems to be a typo in one of the sentences. AG16 reads: “A key characteristic of a binding arrangement is the ability of both parties to enforce the rights and obligations of the arrangement. That is, the transfer recipient receiving the consideration (the transfer recipient) must be able to enforce the promise to receive funding (consideration). Similarly, the transfer recipient providing the funding (the transfer provider) must be able to enforce fulfillment of the obligations assumed by the transfer recipient”. The underlined word should be changed to “provider”.

The following sentence in AG33 is difficult to read due to the number of negatives in the sentence: “For any revenue for which a transfer recipient does not believe it is highly probable that a significant reversal in the amount will not occur, the transfer recipient shall not recognize revenue”. Consideration should be given to re-word this sentence so that its meaning is clearer.

In a couple of instances, the word “term” is used with the intended meaning of “clause” and not “duration”. IE76 is one such example. To prevent confusion we would suggest using “clause” instead of “term” in these situations so as not to be misconstrued with the concept of duration.

IE80 refers to applying paragraphs 31-42 to determine when to recognize an asset. The correct paragraph references that deal with when to recognize an asset are paragraphs 32-43.