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Technical Director
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Re: Consultation Paper "Accounting for Revenue and Non-Exchange Expenses"

Thank you for the opportunity to comment on the proposals in the Consultation Paper. Accounting for Revenue and Non-Exchange Expenses in the Public Sector is an important and difficult topic.

The Canadian Public Sector Accounting Board (PSAB) currently has a project underway to develop an overarching, principles based standard for revenue as well. Our project, however, does not address revenue arising from Government Transfers or Taxes. These topics are specifically addressed in the CPA Canada Public Sector Accounting Handbook, Section PS 3410, *Government Transfers* and Section PS 3510, *Tax Revenue*. Section PS 3510 is substantially based on the tax revenue provisions in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

Responses to the Specific Matters for Comment are set out in the attached document "Appendix A – Accounting for Revenue and Non-Exchange Expenses". As well, we wish to draw the attention of the IPSASB to the following issues:

- **Multiple standards based on a performance obligation approach may cause confusion**. The proposals seem to imply that the result would be two separate IPSAS based on a performance obligation approach and a revised IPSAS 23. We understand that IPSASB has an objective to converge standards with International Financial Reporting Standards where appropriate. However, we are concerned that two IPSAS, both based on a performance obligation approach, may create confusion and unnecessary application issues. We encourage IPSASB to consider whether one IPSAS could be developed, based on a public sector performance obligation approach that would be based on IFRS 15. This would need to be robust enough to address both Category C and B transactions that contain performance obligations or stipulations.
- **Accounting for Non-Exchange Expenses Must Reference the Asset Definition.** We are concerned that the symmetrical accounting forced through the use of a performance obligation approach for non-exchange expenses does not adequately consider whether the asset definition

is met. We believe that the asset definition must be the primary reference for determining whether an asset is recognized by a transferor in relation to a transfer provided by a public sector entity. We do not agree with the assertion in paragraph 6.21 that indicates that a transferor has control of the transferred resources until the recipient breaches the condition(s) related to the transfer. In our view the transfer and the breach of the condition(s) are separate events, with the breach being a possible future event. The transfer of funding to an external party means that the transferor no longer controls those funds. The transferor would only recognize a receivable for the portion of the transferred funds for which the condition has not been met when it has evidence that the breach has occurred. We provide more detail on this issue in Appendix A.

- **Measurement.** Given the current IPSASB project underway regarding Measurement it might be worthwhile to wait and see the results of that project before proceeding with developing measurement guidance for non-contractual receivables and non-contractual payables.

Please note that this letter and the comments in Appendices A and B represent the views of PSAB staff and not those of the Public Sector Accounting Board (PSAB).

Thank you again for the opportunity to provide you with input on this Consultation Paper. We hope you find our comments helpful.

Sincerely,

Sandra Waterson
Principal, Public Sector Accounting

Accounting for Revenue and Non-Exchange Expenses

Response to Consultation Paper

Issued August 2017 with comments due January 15, 2018

Appendix A

Responses to Preliminary Views and Specific Matters for Comment

Preliminary View 1 (following paragraph 3.8)

The IPSASB considers that it is appropriate to replace IPSAS 9, *Revenue from Exchange Transactions*, and IPSAS 11, *Construction Contracts* with an IPSAS primarily based on IFRS 15, *Revenue from Contracts with Customers*. Such an IPSAS will address Category C transactions that:

a) Involve the delivery of promised goods or services to customers as defined in IFRS 15; and

b) Arise from a contract (or equivalent binding arrangement) with a customer which establishes performance obligations.

Do you agree with the IPSASB's Preliminary View 1? If not, please give your reasons.

PSAB Staff Response

PSAB staff agree that a new revenue IPSAS based on IFRS 15, Revenue from Contracts with Customers is appropriate.

PSAB staff understand the convergence strategy, where appropriate, of the IPSASB and agree that both IPSAS 9, *Revenue from Exchange Transactions,* and IPSAS 11, *Construction Contracts*, could be replaced with an IPSAS primarily drawn from IFRS 15, Revenue from Contracts with Customers for Category C transactions.

However, as noted above under general comments, the idea of developing two IPSASs based on a performance obligation approach, one for Category C transactions and one for Category B transactions, may be problematic for the following reasons:

- <u>Application by Stakeholders May Not be Improved</u>:
  - ✓ The criteria to determine which transactions would fall under the appropriate IPSAS, both based on performance obligations may be confusing and result in similar frustrations currently experienced with trying to determine whether a transaction is exchange or non-exchange. Even if applying the 'rules of the road' approach to developing a new IPSAS based on IFRS 15 will require some modifications that are also needed to address the Category B transactions, it may be worth it to reduce potential confusion.

    For example, as noted in Preliminary View 1, the IPSAS developed to address Category C transactions will include transactions that arise from contracts (or equivalent binding arrangements) with a customer that establish performance obligations. The proposed expansion in the Consultation Paper to include transactions that arise from 'equivalent binding arrangements' in addition to contracts may already broaden the scope of transactions captured under such a proposal from that considered in IFRS 15 and may then include some from Category B transactions. The primary focus for both Categories B and C would be on determining whether a performance obligation is present or not.

- ✓ Also, the last point to distinguish Category C transactions from other transactions is that the transaction be on ‘commercial terms’. This phrase is private sector oriented and can be confusing as to what is really meant by ‘commercial terms’ in the public sector. As noted in IFRS 15, paragraph 9 (d), commercial substance is when the risk, timing or amount of the entity’s future cash flows is expected to change as a result of the contract.

  Chapter 4 paragraph 4.47 describes the term ‘commercial substance’ as two characteristics assumed in a contract to deliver promised goods or services to a customer:

  a) The amount of expected revenue will change as a result of changes to the nature, cost, value or volume of the promised goods and services to be delivered; and

  b) The amount of expected revenues reflects the amount to which the entity expects to be entitled in exchange for those goods or services.

  Using this term in the public sector may create similar frustrations to those experienced currently in trying to determine whether a transaction is exchange or non-exchange. Under the Consultation Paper proposals, an entity will need to evaluate its transactions as to whether they contain a performance obligation or stipulation, and then whether it has commercial substance or not to determine the appropriate IPSAS to apply.

- Sufficiently Differentiating Performance Obligations from Stipulations: It was noted in the diagram illustrating the categorization of transactions (page 27) that the characteristic of Category C transactions was enforceable agreements with performance obligations to transfer goods or services to customers on commercial terms. This is compared to Category B transactions that are enforceable agreements with performance obligations or stipulations. This would imply that these Category C transactions do not contain stipulations. If this is correct, the guidance will need to be clear as to how to differentiate a performance obligation from a stipulation.
- Sufficiently Differentiating How Performance Obligations are Fulfilled: Another distinguishing characteristic between Category B and C transactions is that Category C transactions relate to the transfer of goods or services to customers. Category B transactions relate to the use or consumption of resources in a particular way. This wording may lead to some differences in interpretation and will need to be clearly explained. A customer is control of the goods or services when they have the ability to direct the use of and benefit from the good or service. Therefore, the distinction between Category B and C needs to be clear why or how they differ.

Preliminary View 2 (following paragraph 3.9)

Because Category A revenue transactions do not contain any performance obligations or stipulations, the IPSASB considers that these transactions will need to be addressed in an updated IPSAS 23.

Do you agree with the IPSASB’s Preliminary View 2? If not, please give your reasons.

PSAB Staff Response

Agree that guidance will be needed for transactions with no performance obligations or stipulations. However, the Consultation Paper did not elaborate on how the IPSAS 23 would be revised to address Category A transactions. Assuming a performance obligations approach is supported and developed for Category B and C transactions, the revised IPSAS 23 will need to revisit its scope and definitions to ensure it is addressing only those transactions that do not contain performance obligations or stipulations. The definition or references to non-exchange transactions would need to be removed. Such changes would help ensure the initial question for all revenue transactions is whether performance obligations exist or not.

On the other hand, if there is continued support for the non-exchange and exchange distinction, with the necessary clarifications the revised IPSAS 23 could be amended to address the issues currently raised with its application.

Specific Matters for Comment 1 (following paragraph 3.10)

Please provide details of the issues that you have encountered in applying IPSAS 23, together with an indication of the additional guidance you believe is needed in an updated IPSAS 23 for:

- **a)** Social contributions; and /or
- **b)** Taxes with long collection periods.

If you believe that there are further areas where the IPSASB should consider providing additional guidance in an updated IPSAS 23, please identify these and provide details of the issues that you have encountered, together with an indication of the additional guidance you believe is needed.

PSAB Staff Response

PSAB staff have no comments on issues encountered in applying IPSAS 23.

Preliminary View 3 (following paragraph 4.64)

The IPSASB considers that Category B transactions should be accounted for using the Public Sector Performance Obligation Approach.

Do you agree with the IPSAB's Preliminary View 3? If not, please give your reasons.

PSAB Staff Response

PSAB staff agree that a public sector performance obligation approach should be applied to transactions that contain a performance obligation or stipulation. As noted above, we believe this should include both Category B and C transactions. This would simplify the application of the proposals and avoid unnecessary confusion as to which IPSAS would apply in a particular circumstance.

Specific Matter for Comment 2 (following paragraph 4.64)

The IPSASB has proposed broadening the requirements in the IFRS 15 five-step approach to facilitate applying a performance obligation approach to Category B transactions for the public sector. These five steps are as follows:

Step 1 ─ Identify the binding arrangement (paragraphs 4.29-4.35);

Step 2 ─ Identify the performance obligations (paragraphs 4.36-4.46);

Step 3 ─ Determine the consideration (paragraphs 4.47-4.50);

Step 4 ─ Allocate the consideration (paragraphs 4.51-4.54); and

Step 5 ─ Recognize revenue (paragraphs 4.55-4.58).

Do you agree with the proposals on how each of the IFRS 15 five-steps could be broadened? If not, please explain your reasons.

PSAB Staff Response

Step 1 - Identify the binding arrangement

We agree. As noted, many transactions in the public sector include arrangements for the provision of resources that are non-contractual but can still be enforceable obligations. This notion was also demonstrated in the proposals for Category C transactions as the phase ‘or equivalent binding arrangement’ was added to the characteristics of such transactions.

We also agree that enforceability needs to go beyond a return obligation. A return requirement is only one possible aspect of enforceability terms for a contract or other binding arrangement that should be considered.

Possible guidance on enforceability

- Clear and unambiguous terms are necessary for performance to be assessed. If performance under an agreement is not clear, then it may not be possible to evaluate whether a performance obligation has been satisfied.
- An agreement that is cancelable without severe penalty/consequences does not bind the parties to the transaction to any significant degree.
- In an extreme case, such a “contract” may be little more than an expression of intent by the parties involved with virtually no power to bind them. Entering into such an agreement is an insignificant event for purposes of recognizing assets and liabilities.
- A penalty/consequences is considered to be severe if in the normal course of operations an entity would perform what is required under the agreement rather than incur the penalty/consequences.

Step 2 – Identify performance obligations

We agree that you need to consider when promises to deliver goods or services in the public sector are distinct or when they need to be bundled together to enable the identification of performance obligations and to assess when those performance obligations have been fulfilled.

Given that in the public sector the specificity of goods or services promised may vary greatly, it is crucial to develop criteria to determine distinct goods or services.

The criteria to determine whether a good or service is distinct in IFRS 15 would be a good starting point. These criteria would likely be appropriate in the public sector however, some additional thought would be needed for transfers to ensure they are still appropriate.

Staff disagree with the notion that a 'time requirement in and of itself 'would create a performance obligation. A time or return requirement should be irrelevant for initial recognition under a performance obligation approach. A return requirement may affect subsequent recognition, however, if the performance obligation is not satisfied. A determination that the obligation has and will not be satisfied would transform the liability for an unsatisfied performance obligation into a liability for the recipient to return resources to the transferor.

Step 3 – Determine the consideration

We agree that the amount of consideration is needed to be determined in order to allocate it to the identified performance obligations.

In the public sector, the characteristic of commercial substance as described in paragraph 4.47 (a) that refers to 'the amount of expected revenue will change as a result of changes to the nature, cost, value or volume of the promised goods and services to be delivered' may be problematic in the public sector. For example, there could be binding arrangements that contain performance obligations or stipulations that are not fully funded. As indicated earlier, characterizing transactions in this way may cause challenges and result in different interpretations. Therefore, as noted in paragraph 4.48, determining the consideration based on what the resource recipient expects to be entitled to for the promised services is appropriate.

Step 4 – Allocate the consideration

We agree that there may be circumstances where a stand-alone selling price is not available and other methods will need to be provided for allocating the consideration. It is reasonable in the public sector that one such method may be based on the cost of fulfilling the performance obligation.

Step 5 – Recognize revenue

We agree that revenue would be recognized as the performance obligations are fulfilled. As noted in the Consultation Paper, in some circumstances, determining when those performance obligations have been satisfied may be difficult, such as when waiting for a report that all vaccines have been delivered to the general community. The concern is that revenue recognition would be delayed.

Specific Matter for Comment 3 (following paragraph 4.64)

If the IPSASB were to implement Approach 1 and update IPSAS 23 for Category B transactions, which option do you favor for modifying IPSAS 23 for transactions with time requirements (but no other stipulation):

a) Option (b) ─ Require enhanced display/disclosure;

b) Option (c) ─ Classify time requirements as a condition;

c) Option (d) ─ Classify transfers with time requirements as other obligations; or

d) Option (e) ─ Recognize transfers with time requirements in net assets/equity and recycle through the statement of financial performance.

Please explain your reasons.

PSAB Staff Response

PSAB staff prefer Option (b) - Require enhanced display and disclosure option to address transactions with time requirements. This approach is consistent with the element definitions of financial statements and will provide the necessarily information for accountability and decision-making.

Applying either Option (d) or (e) would require a great deal of consideration as these would represent new ground being explored. Option (d), other resources and other obligations were established in the IPSASB's conceptual framework. This category has not yet been used in any IPSAS. A great deal of consideration will be needed to determine whether it is appropriate to start treating timing differences as other resources and other obligations. This type of transaction may not be a precedent that the IPSASB wants to establish; recognition in accordance with time requirements. The IPSASB may want to reserve use of the "other resources" and "other obligations" categories for recognition of complex public sector transactions for which accountability will not be served through recognition of the transaction using the elements of financial statements.

Option (e) to recognize transfers with time requirements in net assets/equity and recycle through the statement of financial performance is an option that has currently been used only for convergence projects with IFRS. Such direct recognition in net assets/equity is articulated in IPSAS 1 (paragraphs 101, 118(b), 121, 123) and it is described as comprising items of revenue and expense that are required by other IPSAS to be excluded from surplus/deficit. Applying this approach to timing differences would be new ground; but it may be a less complex approach for stakeholders than option (d) as direct recognition in net assets/equity is already an established approach in the IPSAS. It should be noted, as well, that direct recognition in net assets or net liabilities –though not in relation to time requirements - is consistent with proposals of PSAB in its new Statement of Principles for a Revised Reporting Model for the Canadian Public Sector (approved in December 2017; expected to be issued in late May/early June 2018 after translation).

Caution is needed when providing illustrative examples of what the disclosures may be and how the disaggregated information maybe presented. As noted in the current example provided for how the disaggregated revenue may be presented in paragraph 4.17, the use of the term 'revenue receivable' for the restricted component of the revenue that is to be used in future periods is somewhat misleading assuming the entity has already received the money.

Specific Matter for Comment 4 (following paragraph 4.64)

Do you consider that the option that you have identified in SMC 3 should be used in combination with Approach 1 Option (a) – Provide additional guidance on making the exchange/non-exchange distinction?

a) Yes

b) No

Please explain your reasons.

PSAB Staff Response

Yes. Given that the exchange/non-exchange is still going to be made, any additional guidance to help understand the difference between those two categories in the public sector would be helpful. The phrases identified in the Consultation Paper, 'directly giving' and 'approximately equal value' are problematic in the public sector and can be interpreted differently.

Preliminary View 4 (following paragraph 5.5)

The IPSASB considers that accounting for capital grants should be explicitly addressed within IPSAS.

Do you agree with the IPSASB's Preliminary View 4? If not, please give your reasons.

PSAB Staff Response

Yes, accounting for capital grants should be addressed within IPSAS. The issues needed to be addressed may be different depending on whether a performance obligation approach is applied or the exchange/non-exchange approach. Addressing this issue will help improve consistency of application and comparability.

Specific Matter for Comment 5 (following paragraph 5.5)

a) Has the IPSASB identified the main issues with capital grants?

   If you think that there are other issues with capital grants, please identify them.

b) Do you have any proposals for accounting for capital grants that the IPSASB should consider?

   Please explain your issues and proposals.

PSAB Staff Response

Agree with main issues identified.

In relation to updating requirements in the IPSAS for capital grants we offer the following:

- Please see Appendix B. It includes excerpts from PSAB's 2007 Re-exposure Draft that set out proposals to revise Government Transfers, Section PS 3410. These proposals were not accepted in Canada. But they were based on IPSAS 23 and tried to add more guidance for making the restriction versus condition distinction required by IPSAS 23, even though such terms were not specifically used in the re-exposure draft. The proposed recipient accounting was for all transfers, including capital grants; so it may be useful in updating IPSAS 23.

- PSAB's ultimate decision in relation to capital transfers received in the new Section PS 3410 was a pragmatic "made in Canada" solution that gives accounting credence to both transferor terms and recipient actions and communications in trying to reflect the substance of individual capital transfers. A couple of Canadian jurisdictions prefer that all capital transfers be accounted for in the same manner and have legislated accounting requirements for capital transfers received to achieve that consistency.

Specific Matter for Comment 6 (following paragraph 5.9)

Do you consider that the IPSASB should:

a) Retain the existing requirements for services in-kind, which permit, but do not require recognition of services in-kind; or

b) Modify requirements to require services in-kind that meet the definition of an asset to be recognized in the financial statements provided that they can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information; or

c) An alternative approach.

Please explain your reasons. If you favor an alternative approach, please identify that approach and explain it.

PSAB Staff Response

Staff agree that they are many challenges associated with developing accounting standards for services in-kind and the cost of obtaining the information needs to be considered against the benefit of providing the information. Additional research is needed to determine the impact of the alternatives above. Nevertheless, if a decision is required, b) would be consistent with the new conceptual framework and therefore wold be a more theoretically defensible approach.

Preliminary View 5 (following paragraph 6.37)

The IPSASB is of the view that non-exchange transactions related to universally accessible services and collective services impose no performance obligations on the resource recipient. These non-exchange transactions should therefore be accounted for under The Extended Obligating Event Approach.

Do you agree with the IPSASB's Preliminary View 5? If not, please give your reasons.

PSAB Staff Response

Agree.

Preliminary View 6 (following paragraph 6.39)

The IPSASB is of the view that, because there is no obligating event related to non-exchange transactions for universally accessible services and collective services, resources applied for these types of non-exchange transactions should be expensed as services are delivered.

Do you agree with the IPSASB's Preliminary View 6? If not, please give your reasons.

PSAB Staff Response

Agree.

However, we note that PV 5 requires use of the Extended Obligating Event Approach and then PV 6 states that there is no obligating event. Although we agree with the ultimate conclusion that expenses should be recognized as the related eservices are delivered, we feel that PV 5 and PV 6 are somewhat contradictory.

Preliminary View 7 (following paragraph 6.42)

The IPSASB is of the view that where grants, contributions and other transfers contain either performance obligations or stipulations they should be accounted for using the PSPOA which is the counterpart to the IPSASB's preferred approach for revenue.

Do you agree with the IPSASB's Preliminary View 7? If not, please give your reasons.

PSAB Staff Response

Agree that it would be beneficial to have consistent approaches for revenue and expenses. Therefore, if a performance obligation approach can be applied to revenues, then there may be merit to applying the same approach to expenses. However, symmetrical accounting should not be forced. A resource provider and resource recipient may not have the same evidence to support recognition and the element definitions should be the ultimate gatekeepers of whether an asset or liability is recognized.

Further, a performance obligation approach for expenses may have additional challenges.

- For example, the expense recognition may be delayed as the resource provider must be able to determine whether the resource recipient or in some cases the resource beneficiary has satisfied the performance obligations. Mechanisms will need to be in place to provide reliable and timely information to indicate when performance obligations are satisfied.

- Performance obligations imposed on a recipient of funding might have no accounting significance for the transferor unless (and until) the obligation is not met. In such cases the transferor might expect to get some funds back or would reduce future funding; and the receivable and revenue recognition would be future events.

- Chapter 6 does not address this possibility and assumes that a performance obligation imposed on recipient of transferred funds would also have an impact on the accounting by the transferor. When funds are provided by a transferor in advance of a performance obligation being met, a prepaid asset is created for the transferor. But a full evaluation of whether the asset definition is met for a transferor when funds that have already flowed is not provided (or if this evaluation is done, no reference to it is included in Chapter 6).

- A transferor does not control the transferred funds until they are used by the recipient for the intended purposes. How would the transferor continue to control these funds? The transferor may have legal recourse to get the funds back if the performance obligation is not satisfied but retains no control of the funds transferred once they are gone. They become an asset of the recipient and give rise to the related performance obligation liability for the recipient.

Preliminary View 8 (following paragraph 7.18)

The Board considers that at initial recognition, non-contractual receivables should be measured at face value (legislated amount) of the transaction(s) with any amount expected to be uncollectible identified as an impairment.

Do you agree with the IPSASB's Preliminary View 8? If not, please give your reasons.

PSAB Staff Response

PSAB staff do not agree with initial recognition of non-contractual receivables to be measured at face value (legislated amount) with the amount expected to be uncollectible identified.

The CPA Canada Public Sector Accounting Handbook, TAX REVENUE, paragraph PS 3510.09 states, "A government would only recognize tax revenue that it expects to collect in accordance with the general recognition criteria in FINANCIAL STATEMENT CONCEPTS, paragraph PS 1000.55. If at the time the tax is imposed, the government expects for specific or exceptional reasons that it is unlikely to collect it, the tax revenue would not be recognized…."

Furthermore, the recently issued Exposure Draft, Revenue, Proposed Section PS 3400, notes that a public sector entity recognizes only those future economic benefits it expects to obtain. In this regard, two circumstances have been identified as critical to revenue recognition. Revenue is expected when the public sector entity:

(a) has the information required to record the transaction; and

(b) is able to enforce payment.

Preliminary View 9 (following paragraph 7.34)

The IPSASB considers that subsequent measurement of non-contractual receivables should use the fair value approach.

Do you agree with the IPSASB's Preliminary View 9? If not, please give your reasons.

PSAB Staff Response

The IPSASB has a Measurement project underway, perhaps it would be better to wait and see what conclusions are reached in that project.

Having said that, Approach 3 – the cost approach may be more straightforward and understandable for users. This approach would require fewer decisions on interest rates. Also, it could be argued that non-contractual receivables that arise from taxes and fines and penalties for example are not really 'financing transactions'.

Specific Matter for Comment 7 (following paragraph 7.46)

For subsequent measurement of non-contractual payables do you support:

a) Cost of Fulfillment Approach;

b) Amortized Cost Approach;

c) Hybrid Approach; or

d) IPSAS 19 requirements?

Please explain your reasons.

PSAB Staff Response

The IPSASB has a Measurement project underway, perhaps it would be better to wait and see what conclusions are reached in that project.

Having said that, the cost of fulfillment approach seems the most straightforward and easy to understand.

Appendix B
Excerpts from PSAB's 2007 Re-exposure Draft for Government Transfers, Section PS 3410

Note: These proposals were not accepted in Canada. But they were based on IPSAS 23 and tried to add more guidance for making the restriction versus condition distinction required in IPSAS 23, even though such terms were not specifically used in the re-exposure draft.

Highlights to Re-Exposure Draft - Recipient Government

The proposals in the Re-Exposure Draft require a transfer to be recognized as revenue in the period the transfer is authorized and any eligibility criteria are met, except when and to the extent that the transfer stipulations create a liability in accordance with LIABILITIES, Section PS 3200. This proposal is similar to IPSAS 23.

The nature, extent and specificity of the transfer stipulations are fundamental to distinguishing revenue from liability. If the transfer stipulations establish both substantive performance and return requirements, the recipient will initially recognize a liability and revenue will be subsequently recognized as the stipulations are met.

When substantive performance and return requirements are included in the stipulations, this creates a liability for a recipient government. The recipient government has no discretion to avoid the sacrifice of future economic benefits (i.e., either to the ultimate beneficiaries of the goods or services to be provided or back to the transferor). A present obligation is imposed on a recipient government by its acceptance of a transfer with both substantive performance and return requirements.

A performance requirement has substance when it is specifically identifiable and permits the objective assessment of non-compliance. Normally, a performance requirement is identifiable when the stipulations define the nature of the future economic benefits to be sacrificed by the recipient through a specific purpose stipulation combined with time stipulations. This leaves the recipient with little or no discretion over the use of the asset and the time period it is to be used.

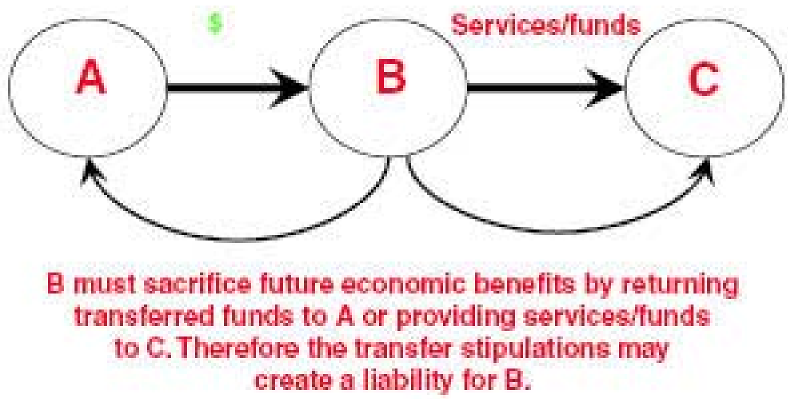
A return requirement has substance when it is specifically identifiable, related to a breach of the performance requirements and enforceable. The nature and extent of the accountability stipulations included in the transfer terms would be evaluated to determine if they impose an identifiable and enforceable return requirement on a recipient government. Stipulations would not create a liability unless the return requirement is sufficiently explicit to ensure that the recipient must use the resources as specified or return the resources or their equivalent to the transferor. It is the existence of an explicit, substantive return requirement coupled with a substantive performance requirement that indicates a recipient has lost its discretion to make individual choices, judgments or decisions relating to the asset, thus prompting liability recognition.

Stipulations would not create a liability unless the performance requirement is defined in a manner that permits objective assessment of non-compliance. If non-compliance cannot be objectively assessed, determining when a return requirement would be triggered also cannot be assessed. The return requirement would lack sufficient enforceability and the stipulations would not create a liability for a recipient government.

A performance requirement alone is insufficient, as the recipient retains some discretion to avoid the sacrifice of resources back to the transferor. An implied requirement to return resources to the transferor is also insufficient to remove the recipient government's discretion.

The following diagram illustrates B's limited choices as a recipient of a transfer with both substantive performance and return requirements.

Transfer received or receivable with performance requirement and return requirement



Excerpt from the text of the re-exposure draft

Recipient government

.15 ► *A government transfer should be recognized by a recipient government as revenue in the period the transfer is authorized as described in paragraph PS 3410.28 and eligibility criteria, if any, have been met by the recipient, except when and to the extent that the transfer stipulations create a liability in accordance with* LIABILITIES*, Section PS 3200.*

.16 Transfer terms described as eligibility criteria but not met before a transfer is provided by the transferor would be considered stipulations for the purposes of paragraph PS 3410.15.

.17 ► *A liability recognized in accordance with paragraph PS 3410.15 should be reduced and an equivalent amount of revenue recognized as the transfer stipulations are met.*

.18 The standards in paragraphs PS 3410.15 and PS 3410.17 apply equally to an operating transfer, a capital transfer and a transfer of a tangible capital asset.

.19 For a capital transfer recognized as a liability in accordance with paragraph PS 3410.15 transfer stipulations would require revenue recognition as the related asset:
(a) is acquired or developed; or
(b) is used to provide goods or services to third parties over the specified period up to a maximum of its useful life.

.20 The transfer of a tangible capital asset would be recognized by a recipient government in the amount of the asset's fair value (see TANGIBLE CAPITAL ASSETS, Section PS 3150). For a transfer of a tangible capital asset recognized as a liability in accordance with paragraph PS 3410.15 transfer stipulations would require revenue recognition as the asset is used to provide goods or services to third parties over the specified period up to a maximum of its useful life.

Stipulations

.21 ► *To create a liability for a recipient government in accordance with paragraph PS 3410.15, transfer stipulations should collectively establish both substantive performance and return requirements.*

.22 Performance and return requirements are substantive when:

(a) The performance requirement is identifiable from the stipulations and permits objective assessment of non-compliance.

(b) The return requirement is identifiable from the stipulations, related to a breach of the performance requirements and enforceable.

When stipulations establish both types of requirements, a recipient government loses its discretion to avoid a sacrifice of future economic benefits. It must either use the transferred resources as specified or return them or their equivalent[7] to the transferor.

.23 Normally, a performance requirement is identifiable when the stipulations:

(a) define the nature of the future economic benefits to be sacrificed by the transfer recipient through a **purpose stipulation** that leaves the recipient with little or no discretion over the use of the transferred resources; and

(b) establish future **time stipulations** that leave the recipient with little or no discretion over the period(s) in which the transferred resources are to be used or consumed. LIABILITIES, Section PS 3200, requires that the timing of the sacrifice of economic benefits in the future be specified.

.24 Transfer terms that require ongoing monitoring of performance and impose related consequences for non-compliance are called **accountability stipulations**. The nature and extent of the accountability stipulations would be evaluated to determine if they impose an enforceable return requirement on a recipient government. In the absence of an enforceable return requirement in the stipulations, a recipient government would not recognize a liability in relation to a transfer. It is this additional requirement that removes any discretion of the recipient government to avoid a sacrifice of future economic benefits related to the transferred resources.

.25 Stipulations would not create a liability for a recipient government unless the performance requirement is defined in a way that permits objective assessment of non-compliance. A broad functional description such as "health", "education" or "transportation" or a broad purpose stipulation such as "operating" or "capital" would not be specific enough for non-compliance with the performance requirement to be objectively assessed. If non-compliance cannot be objectively assessed over the term of a liability recognized in accordance with paragraph PS 3410.15, the timing of when a return requirement would be triggered also cannot be assessed. In such cases, the return requirement lacks sufficient enforceability and therefore the stipulations would not create a liability for a recipient government.

.26 If the accountability stipulations do not allow for the monitoring of performance over the term of a liability recognized in accordance with paragraph PS 3410.15, the timing of when a return requirement would be triggered cannot be assessed and the stipulations would not create a liability for a recipient government.