

1 November 2020

Mr Ian Carruthers
Chairman
International Public Sector Accounting Standards Board
529 Fifth Avenue
New York, NY 10017 USA
Via online submission: www.ipsasb.org

Dear Ian

Joint submission on ED 71 *Revenue without Performance Obligations*

As the representatives of over 200,000 professional accountants in Australia, Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia thank you for the opportunity to comment on ED 71 *Revenue without Performance Obligations* ("ED 71").

CA ANZ and CPA Australia support the development of a revenue recognition model, with principles, requirements and guidance, that goes beyond what is currently possible through the application of the principles and requirements in IFRS 15 *Revenue from Contracts with Customers* (and ED 70 *Revenue with Performance Obligations*). We believe these proposed improvements will not only improve the quality of financial information and strengthen financial decision-making, but also provide relevant information to users of public sector financial statements.

Although we support the development of a new revenue recognition model, we have both conceptual and practical concerns with the proposals in ED 71. Some concepts in ED 71 appear to diverge from the Conceptual Framework and existing IPSAS literature. Guidance provided to support the requirements and concepts is generally unclear and unnecessarily complex. We are concerned that, instead of clarifying the extant issues in IPSAS 23 *Revenue from Non-exchange Transactions*, ED 71 potentially replaces them with new issues.

Our stakeholders have questioned the rationale as to why the requirements and guidance in ED 71 are proposed as a separate Standard from ED 70. We recommend that the IPSASB considers developing one Standard that addresses the proposals in both ED 70 and ED 71. We are cognisant of the desire for IFRS convergence in ED 70, and the development of separate proposals in ED 71 that seek to address public-sector specific economic transactions not currently addressed in IFRS. However, we note that there are differences between ED 70 and IFRS 15 including:

- revenue transactions arising from public sector binding arrangements which were not considered during the development of IFRS 15, and
- the definition of revenue.

One possible avenue toward a more cohesive approach that the IPSASB may wish to explore is to expand the concept of “performance obligations” (as detailed in ED 70) to include arrangements envisaged in ED 71. This approach would not only ensure the requirements are contained in one Standard, but also address the concerns we raise with the current proposed approach in ED 71. We appreciate this may require some consequential redevelopment of the proposals in ED 72 *Transfer Expenses*.

We believe the IPSASB needs to develop its proposals further for the reasons stated above and in our detailed responses in the **Attachment**.

Should you have any questions about the matters raised in this submission or wish to discuss them further, please contact either Amir Ghandar (CA ANZ) at amir.ghandar@charteredaccountantsanz.com or Ram Subramanian (CPA Australia) at ram.subramanian@cpaaustralia.com.au.

Yours sincerely

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Attachment

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 do not agree with these proposals in Specific Matter for Comment 1 (SMC 1). Our outreach to members and other key stakeholders suggests that, rather than addressing the challenges of revenue deferral highlighted below, the proposals create additional and different challenges relating to:

- Complexity;
- Current understanding of liabilities; and
- Capital transfers.

We explain these new challenges in detail below. However, as stated in our cover letter, this is an important project and we encourage the IPSASB to address these issues in further developing these proposals.

Complexity

The proposals make it difficult to distinguish performance obligations under ED 70, present obligations under IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* (IPSAS 19) and/or ED 71, as well as ‘no obligations’ under ED 71.

Also, the concepts of performing specified activities and/or incurring eligible expenditure are often intermingled and difficult to separate in practice. Not only are these concepts difficult to separate; distinguishing them from other activities and expenditure can also be challenging. We do not believe that using the proposed concepts of ‘performing specified activities’ and ‘incurring eligible expenditure’ to determine whether there is a present obligation, makes the cut off point for revenue deferral clearer. Rather, they add to the complexity.

Our stakeholders have raised the following complexity issues arising from the proposals:

- Differentiating between “performance obligations” in ED 70, “present obligations” in ED 71 and “present obligations” in IPSAS 19;
- Time-consuming effort when considering whether to apply ED 70 or ED 71; and
- Identifying which parties to the binding arrangement should apply which proposed Standard. Given the close relationships between these EDs we believe there is a need for greater clarity on this point. Although Table 1 in the At-a-glance document accompanying ED 71 provides guidance on such identification it remains a time-consuming exercise.

Some commentators mentioned that the “Entity A” and “Entity B” naming conventions in Table 1 was not helpful.

To address the above complexity issues, our stakeholders have suggested that:

- The requirements and guidance in ED 71 be incorporated with the requirements and guidance in the proposed Standard to be developed from ED 70; and
- The ambit of “performance obligations” be expanded to accommodate for the situations described currently in ED 71 (in other words, ‘ED 71 present obligations’ should be part of ED 70 performance obligations).

By incorporating the requirements and guidance of ED 71 into ED 70, complex considerations regarding the scope of each proposed Standard would not be necessary. We understand that incorporating the requirements and guidance of ED 71 into ED 70 means that ED 70 would diverge even more from IFRS 15, but we believe divergence from IFRS is unavoidable. Our stakeholders noted that the applicability and usability of IPSAS are more important considerations than IFRS convergence.

Accordingly, whilst we appreciate the IPSASB’s intentions in developing a Standard that aligns with IFRS 15 (ED 70), we believe a better solution would be to develop a ‘fit for purpose’ public sector Standard that adequately meets the revenue/income recognition needs of the public sector. Such a Standard should build on the existing requirements in IFRS 15 and provide additional/different requirements tailored to meet public sector needs.

To this end, we believe that the requirements and guidance in ED 70 applying to an entity-purchaser relationship in a binding arrangement should be reconsidered as it is very different to the IFRS 15 entity-customer relationship by means of a contract. The definition of revenue in IFRS is also different to the IPSAS definition. Therefore, divergence from IFRS 15 is unavoidable, and combining ED 70 and 71 into one Standard would be justifiable.

Our stakeholders are of the view that, if the characteristics and attributes of performance obligations relating to revenue from binding arrangements are properly defined and dealt with within one Standard, the requirements and guidance would be much less onerous to interpret and apply.

As an alternative, the IPSASB may consider keeping ED 70 and ED 71 separate, but still widen the ambit of “performance obligations” in ED 70 to include ‘present obligations’ envisaged in ED 71. This would result in the proposals in ED 71 being limited to addressing revenue without both performance obligations and present obligations. Our preference however is for a combined Standard.

Current understanding of liabilities

We are concerned about the implications of the proposals in ED 71 for the existing understanding of when liabilities should be recognised, as described in the Conceptual Framework and IPSAS 19. Having the same term, “present obligation,” in both ED 71 and IPSAS 19, is confusing. Our stakeholders also found it confusing having a separate term for “performance obligations” in ED 70 and “present obligations” for potentially the same binding arrangement and/or transfer provider-recipient relationship in ED 71.

Furthermore, it is sometimes not clear from ED 71 whether the “present obligation” *to incur eligible expenditure or carry out a specified activity* is an obligation towards the transfer provider. We believe the nature of the liability is the same whether it is a liability to return resources to the transfer provider, or a liability to incur eligible expenditure and/or carry out a specified activity. Both are commitments towards the same transfer provider and not with third parties.

For example, paragraph 17 does not specify that the obligation *to incur eligible expenditure or carry out a specified activity* is with the transfer provider (and not to other parties). We believe that the ‘other party’ of the liability for the “performance obligation” under ED 70 and for the “present obligation” under ED 71 is the transfer provider (and not third parties). The nature of the liability in both cases is related to revenue deferral, which is linked to a binding arrangement. This similarity would also justify our recommendation to merge the proposals into one Standard.

The issues around our current understanding of liabilities are complicated further by the discussion in paragraphs 22-26 (“Enforceability of binding arrangements – substance over form”). Those paragraphs require subjective judgements that are difficult to apply in practice. Also, the “substance over form” discussion in those paragraphs appears to conflict with the Conceptual Framework (CF). ED 71 confuses legally binding obligations (CF paragraph 5.22) with non-legally binding obligations (CF paragraphs 5.23-5.26).

We encourage the IPSASB to consider the “present obligation” in ED 71 in the context of “legally binding” or “non-legally binding” obligations as set out in the CF to ensure consistency.

We do not agree with paragraph 24 of ED 71 that states that:

If past experience or knowledge indicates that the transfer provider never enforces an arrangement if a breach occurs, then the transfer recipient may conclude that the arrangement is not enforceable in substance.

We believe a binding arrangement does not require a history of enforcement of similar agreements or even an intention of the customer to enforce rights. Enforceability depends solely on the customer’s (transfer provider) capacity to enforce its rights. The Australian Accounting Standard AASB 15, paragraph F16 contains useful guidance to consider on this matter.

Capital Transfers

We do not believe the proposals in ED 71 adequately address the accounting for capital transfers. There is insufficient clarity around whether capital transfers should be recognised over the construction period of the underlying asset, or over both the construction period and the period over which the asset is utilised to fulfil the conditions of the binding arrangement. We suggest that the IPSASB further develops the accounting requirements proposed in paragraphs 108 and 109 and accompanying Application Guidance to provide sufficient guidance on how to account for capital transfers. We also suggest that the IPSASB should clarify the definition of capital transfers with respect to whether such transfers should relate to specific assets (e.g. a building) or capital assets in general (e.g. roads).

Australian context and background

The AASB adopted and adapted IFRS 15 in AASB 15 and developed Appendix F to AASB 15 to provide additional implementation guidance for applying the principles and requirements of IFRS 15 to not-for-profit constituents including public sector entities. The AASB also developed AASB 1058 *Income from Not-for-profit Transactions* (AASB 1058) to address income that is not addressed in AASB 15.

Feedback we have received from our Australian constituents indicates there are practical challenges in applying the principles and requirements in AASB 15 and AASB 1058 for public sector and not-for-profit sector revenue/income recognition. This includes constituents seeking to defer revenue received through grants and other sources, where such grants place obligations on the recipient that need to be fulfilled over a period of time. However, these obligations do not meet the AASB 15 / IFRS 15 or AASB 1058 criteria for revenue deferral. Examples we have encountered include research grants – a topic discussed in ED 71.

This topic has also been discussed by the AASB, as constituents have sought clarity around the application of AASB 15 / AASB 1058 to research grant arrangements. We understand inconsistencies in applying the requirements of AASB 15 and AASB 1058 continue to arise. We are also aware of circumstances where entities are seeking to treat receipts as a financial liability on the basis of “termination of convenience” clauses included in the agreement. This allows entities to defer the receipts as a financial liability and derecognise them as the obligations in the agreement are fulfilled. These matters highlight practical challenges associated with the application of IFRS 15 principles to certain public sector arrangements that give rise to revenue/income recognition challenges.

In the August 2017 Consultation Paper, *Accounting for Revenue and Non-Exchange Expenses*, the IPSASB identified the need to develop accounting requirements for transactions that were neither non-exchange transactions (addressed in IPSAS 23) nor revenue transactions that were based on enforceable obligations with performance obligations (proposed to be addressed through ED 70 that is based on IFRS 15). We acknowledge that the IPSASB has sought to address this previously identified need through the proposals set out in ED 71. Whilst we support the intentions of the IPSASB in developing the proposals in ED 71, for the reasons stated in this submission, we believe the IPSASB should develop its proposals further to ensure the needs of stakeholders are suitably addressed.

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?

We believe that the flowchart illustrates the process, subject to the following comments:

- The flowchart does not adequately deal with the scope paragraphs of ED 71. We suggest the flowchart keeps to the process in ED 71 and does not confuse readers by references to other Standards if they are not needed (e.g. references to ED 70 and IPSAS 19).

- The blocks in the flowchart dealing with ED 70 should refer to the scope paragraph, not the application guidance.
- The flowchart is conceptually incorrect in relation to considering disclosure where an asset is not recognised (i.e. when the answer is “no” to the first question at the top of the flowchart). The next step in the flow chart is then disclosure; however, our view is that disclosure is only considered when an item does meet the definition of an asset but does not satisfy recognition criteria (see the CF, par. 6.9 and ED 71, par. 44).

Specific Matter for Comment 3 (Paragraphs 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?

As stated in our response to SMC 1, we believe the guidance is too complex to apply. We have both conceptual and practical concerns, and therefore encourage the IPSASB to reconsider the requirements set out in the main section of the proposed Standard, along with the proposed guidance that accompanies them.

Paragraphs 54-55 require the recognition of revenue as a residual amount after the liability is recognised. This appears to conflict with paragraphs 57-58 as these paragraphs require the recognition of revenue first, followed by the recognition of a liability as a residual amount.

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?

As stated in our response to SMC 1, we believe that in practice, it would be difficult to allocate the transaction price between specified activities and eligible expenditure. We also do not believe there is sufficient guidance to assist with splitting the components of the transfer between transactions that fall within the scope of ED 70 and transactions that fall within the scope of ED 71.

As stated in our response to SMC 3 above, paragraphs 54-55 require the recognition of revenue as a residual amount after recognising the liability, which appears to conflict with paragraph 81, which requires the recognition of revenue first, followed by the recognition of the liability as a residual amount. We suggest that the IPSASB gives consideration to the structure and approach taken in AASB 1058 as this Standard sets out clear logic on the recognition of a liability with reference to other Standards in the first instance, followed by the recognition of revenue as a residual amount.

Although AASB 1058 does not adequately address the need for revenue deferral that is intended in ED 71, we suggest that the IPSASB gives consideration to the structure and logic adopted in AASB 1058 as a way forward in further developing the proposals in ED 71.

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 agree that receivables that are financial instruments should be subsequently measured in accordance with IPSAS 41. However, we believe that the application of the amortised cost requirements in IPSAS 41 to receivables not within the scope of IPSAS 41 (i.e. that are not financial instruments) should be complemented by additional application guidance.

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?

We believe that the disclosure requirements are too onerous and will result in disclosures that are unnecessarily long and complex, especially when compared to the disclosures proposed for revenue transactions within scope of ED 70 and to the disclosures required in IPSAS 23. Disclosure requirements that are too complex do not aid user understandability of financial statements.

We request that the IPSASB provides an explanation in the Basis for Conclusions of how disclosures proposed for binding arrangement balances and allocations of transaction prices are relevant to the decision-making needs of users.

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?

The comments we have provided in our cover letter and in our responses to SMC 1-6 above are relevant to this SMC.

We note that obligations under IPSAS 19 are scoped out of ED 71 (paragraph 3(h)), but paragraph AG23 deals with obligations under IPSAS 19. This appears to be duplication of IPSAS 19 content.

We also note that the “incurring some other form of penalty” requirement in paragraph 16 is also included in paragraph 21 for eligible expenditure, but not for specified activities in paragraph 19. It is unclear what is meant by the term “another form of redress” in paragraph 19.