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The International Public Sector Accounting Standards Board

277 Wellington St. West  
Toronto, ON  
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Submission via website

30 October 2020

Dear Ross

### **COMMENTS ON ED 71 ON REVENUE WITHOUT PERFORMANCE OBLIGATIONS**

We welcome the opportunity to provide comments on Exposure Draft (ED) 71 on *Revenue without Performance Obligations*. We commend the IPSASB's efforts to update IPSAS 23 on *Revenue from Non-exchange Transactions (Taxes and Transfers)* in an effort to address constituents' concerns with the application of IPSAS 23.

The comments outlined in this response have been developed by the Secretariat of the ASB and not the Board.

#### *General*

We issued ED 70 on *Revenue with Performance Obligations*, ED 71 on *Revenue without Performance Obligations* and ED 72 on *Transfer Expenses* as a package of documents for comment locally. We arranged a series of education sessions (eleven), roundtable discussions (ten) and engagements with specific stakeholders (four) to solicit views from preparers, auditors, technical experts, academics, consultants, professional bodies and users.

The level of engagement on the documents and the feedback we received on the proposals was limited. This was due to the volume and complexity of the material published for comment. To improve the quality of the comments received in future, it would be helpful if the IPSASB considers constituents' time and ability to engage with the documents.

We also note that it may be useful for the IPSASB staff to consider releasing additional educational material to assist with the understanding of the principles in the EDs. We (and our stakeholders) found the At-A-Glance document and the video helpful but note that it only

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explained the concepts in the EDs at a very high level. It might be useful to produce additional videos on specific issues within the EDs - explained at a more detailed level - to help respondents understand the proposals.

#### *Overall impressions of ED 71*

We appreciate the time and effort the IPSASB has invested in developing ED 71 to address the concerns constituents have expressed with the application of IPSAS 23.

However, we have reservations about the approaches and/or principles outlined in ED 71. Most notably, these reservations relate to:

- The application of private sector principles from IFRS 15 on *Revenue from Contracts with Customers* to the types of transactions in the scope of ED 71. As noted in our comment letter on ED 70, the areas of our concern include assessing whether an entity has an asset with reference to the “ability and intention to pay the transaction price” from ED 70, and the disclosure requirements for transactions with present obligations that mirror those for transactions with performance obligations.
- The use of private sector principles to measure transactions in ED 71, including the use of “transaction price” as in ED 70, especially for taxes, and the requirement to apply amortised cost as in IPSAS 41 on *Financial Instruments* to subsequently measure non-contractual receivables.
- Insufficient guidance in certain areas where private sector principles from IFRS 15 are incorporated in ED 71, including guidance on allocating the transaction price and determining how an entity satisfies present obligations (over time or at a point in time).
- The definition of “binding arrangement”, as noted in our response to specific matter for comment 1 of ED 70. In ED 71, we are concerned about how this is applied to transactions with present obligations, and the conclusion that major sources of government revenue do not arise from “binding” or “enforceable” arrangements, for example taxes and certain transfers.
- The assessment of transactions with present obligations which is potentially inconsistent with the definition of a liability and the *Conceptual Framework for General Purpose Financial Reporting in the Public Sector* (Conceptual Framework) and IPSAS 19 on *Provisions, Contingent Assets and Contingent Liabilities*.
- The guidance to identify and separate transactions with components in ED 70 and ED 71 respectively, as indicated in our response to specific matter for comment 3 of ED 70.

#### *Responses to the proposals in ED 71*

Our comments on ED 71 are set out as follows:

- Annexure A – Responses to specific matters for comment
- Annexure B – Other significant issues
- Annexure C – Drafting and other comments

We noticed editorial amendments when reviewing ED 71 but have not included these in our comments. A final editorial review should be done once the text has been finalised.

If you have any questions regarding our responses, please feel free to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read "Poggiolini". The signature is written in a cursive, flowing style with some loops and flourishes.

Jeanine Poggiolini

Technical Director

## ANNEXURE A – RESPONSES TO SPECIFIC MATTERS FOR COMMENT

### Specific Matter for Comment 1:

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 support the assessment in ED 71 of how specified activities and requirements to incur eligible expenditure give rise to liabilities. We believe the application of the principles in ED 71 results in the recognition of liabilities that is not aligned to the Conceptual Framework and IPSAS 19.**

We disagree that the changes to ED 71 (from IPSAS 23) on what gives rise to a present obligation is aligned to the Conceptual Framework and IPSAS 19.

#### *Assessment of present obligation and what gives rise to liabilities*

ED 71 describes a present obligation in paragraph 14 as “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”. We agree with this description of a present obligation.

ED 71 explains in paragraph 16 that a present obligation (specified activity or requirement to incur eligible expenditure) gives rise to a liability because there is:

- A past event: the transfer provider and transfer recipient enter into a binding arrangement, creating enforceable rights and obligations on both parties.
- An outflow of resources: the transfer recipient cannot avoid using those resources either to fulfil the requirements in the binding arrangement or in the event of a breach of a binding arrangement, repaying the resources to the transfer provider or incurring some other form of penalty (own emphasis added).
- No realistic alternative to avoid outflow of resources: the binding arrangement is enforceable.

We disagree with the assessment of an outflow of resources, as emphasised above. We are of the view that an outflow of resources in the form of a penalty or similar is the result of enforcement procedures when a binding arrangement is breached, which is a separate event that should be accounted for separately. We are of this view for the following reasons:

- The obligating event that gives rise to a present obligation for a penalty is the breach of a binding arrangement and may depend on whether or when the transfer provider takes legal

or similar action against the transfer recipient. An entity does not have this present obligation upon entering onto a binding arrangement<sup>1</sup>.

- A penalty from breaching a binding arrangement does not affect the enforceability of the outflow of the resources related to the specified activity or eligible expenditure. A penalty that may be instituted against a transfer recipient when breaching a binding arrangement would follow a separate legal or similar process. The timing and/or amount of the penalty may be uncertain and may be unrelated to the resources transferred.
- Entities enter into binding arrangements with the intention of fulfilling their obligations. Considering potential outflows of resources from penalties when a binding arrangement is breached in assessing whether an entity has a liability at inception does not support this presumption.

Therefore in our view, the potential outflow of resources from a penalty for breaching a binding arrangement should be recognised and measured separately as a liability when the past event has occurred and other criteria for the recognition of a liability have been met (e.g. the outflow of resources can be reliably measured).

On their own, we do not believe that a requirement to incur eligible expenditure or undertake a specified activity give rise to present obligations. There must be a return obligation<sup>1</sup> of those resources to meet the definition of a present obligation, and therefore a liability. We are of the view that the return obligation should be specific to an arrangement for it to be considered as part of the arrangement. For example, a broad legislative requirement for entities to return surplus funds at the end of a reporting period to the fiscus or central revenue fund would not be a return obligation related to specific transfers.

We note that our view is aligned to the requirements of IPSAS 23. In IPSAS 23 only conditions with return obligations give rise to liabilities. Restrictions on how transferred resources may be used without return obligations do not give rise to liabilities. An outflow of resources in the form of a penalty is the result of enforcement procedures when a binding arrangement is breached, which is a separate event.

We note that specified activities and eligible expenditure may be conditions or restrictions in IPSAS 23. Based on the change from conditions to specified activities or eligible expenditure, ED 71 inappropriately gives rise to more instances where liabilities are recognised in lieu of revenue than IPSAS 23.

Consider the following example to illustrate the issue we foresee with the proposals in ED 71. The example illustrates why we do not believe it is appropriate to include possible outflows based on separate obligating events, such as fines and penalties from breaches, in the initial assessment of a present obligation. The example is roughly based on illustrative example 13 from ED 71.

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<sup>1</sup> We see a distinction between an outflow of resources in the form of a return obligation where a transfer is unspent or not spent according to the binding arrangement specifications, and a penalty or fine instituted by a transfer provider when a binding arrangement is breached. We believe the distinction exists because a return obligation is practice in the public sector and in many arrangements, it is part of the terms of the arrangement, rather than a consequence of breaching the terms of the arrangement. A return obligation is an indication that a transfer provider wishes to retain control of the resources transferred and therefore gives rise to a liability for the transfer recipient.

The national Department of Transport (transfer provider) provides CU10 million to a provincial Department of Transport (transfer recipient) to improve mass transit in the region for a one year period. The arrangement becomes binding on 1 January, which is the first day of the provincial department's reporting period.

The money is required to be used as follows:

- 40 percent (CU 4 million) for the modernisation of the existing railroad and tramway system of the provincial department.
- 40 percent (CU 4 million) for a new railroad and tramway system of the provincial department.
- 20 percent (CU 2 million) to purchase rolling stock for the provincial department.

Under the terms of the arrangement, the money can only be used as specified. The arrangement requires the transfer recipient to spend the funds as specified in the reporting period BUT there is no requirement to return the funds if not spent as required. The transfer provider may institute procedures for the breach of the arrangement against the transfer recipient, which may result in a fine or penalty imposed on the transfer recipient.

Applying ED 71, the spending requirements are identified to be three separate present obligations. The journal entries are as follows:

Day 1 of binding arrangement: Recognise asset and related liability when definition and recognition criteria of asset met.

Dr. Bank / receivable	CU10 mil	
		Cr. Liability
		CU10 mil

At reporting date, the transfer recipient has satisfied the first two present obligations, i.e. it did not purchase the rolling stock of CU 2 million.

At reporting date: Recognise revenue for present obligations satisfied.

Dr. Liability	CU8 mil	
		Cr. Revenue
		CU8 mil

The binding arrangement requires the transfer recipient to satisfy all the present obligations in the reporting period, or a fine or penalty may be incurred when the arrangement is breached. Since there is no requirement for the transfer recipient to return unspent funds, it is unclear how an entity should account for the remaining CU2million liability. It is further unclear what the remaining CU2 million liability represents. It is unlikely that the transfer provider would have taken steps, which may include legal action, at this time to institute a fine or penalty for the breach. Whether a fine or penalty will be incurred may still be unclear, and where there is a clear indication of such an outflow, the amount and/or timing may be uncertain.

We believe this example illustrates why it is inappropriate to recognise a liability upfront where there is no return obligation in an arrangement. If there was a return obligation, the remaining CU2 million liability would represent the unspent funds required to be returned to the resource provider and would be settled by paying back the funds. We do not support

that the remaining CU2 million liability represents the possible fine or penalty that could be instituted against the entity as such actions may not yet have been taken and the amount and/or timing may be uncertain.

#### *Practical application*

A minority of stakeholders locally supported that specified activities and requirements to incur eligible expenditure give rise to liabilities, irrespective of whether the binding arrangement contains a return obligation. For practical reasons, these stakeholders were in favour of recognising a liability instead of revenue when the asset is recognised, and effectively delaying revenue recognition. The practical reasons included that the “matching” of revenue and expenditure in financial statements would be more aligned to how entities report on spending to transfer providers.

On balance, we are of the view that the IPSASB should develop principle-based standards that are conceptually sound.

**RECOMMENDATION:** We propose that the IPSASB removes the guidance that indicates an outflow of resources from breaching a binding arrangement is part of the assessment of whether a binding arrangement initially contains present obligations. We believe an entity only has a present obligation initially where an arrangement includes a return obligation, aligned to IPSAS 23. We propose that the IPSASB considers alternative ways in which the difficulties expressed with IPSAS 23 could be resolved, for example – enhanced display or disclosure about multi-year grants.

If retained, we propose that the IPSASB add guidance to explain how an entity should account for a liability that remains where funds are unspent but there is no return obligation in the arrangement (as illustrated in the example above). We also propose that the IPSASB explains in the basis for conclusions its decision to change the principles of what gives rise to a liability from IPSAS 23, and how it would still be aligned to the Conceptual Framework and IPSAS 19.

#### *Other examples of present obligations*

We have not identified any other examples of present obligations that should be included in the Standard.

Stakeholders however had questions about whether certain transfers in legislation that are unconditional in IPSAS 23 could be seen as transfers with present obligations. The questions arose in the context of various pieces of legislation that, when read together, could be seen to give rise to transactions with present obligations. For example, transfers with the following attributes:

- A legal process establishes the transfer, and it is linked to entities’ budgets and performance plans that indicate how the transfer will be spent.
- Legislation requires entities to report on actual compared to planned financial and performance information to hold entities accountable for spending in accordance with their budget and performance plans.
- Legislation requires entities to return any surplus funds at the end of the reporting period, to the fiscus or central revenue fund.

We do not believe that a transfer as described above would give rise to present obligations, but the guidance in ED 71 may be unclear.

**RECOMMENDATION:** Additional guidance would assist entities in assessing whether an arrangement includes present obligations. We note that the application guidance provided in ED 70 paragraphs AG36 and AG37 could be useful to include in ED 71. Instead of explaining how performance indicators are not performance obligations, the guidance could explain the distinction between performance indicators and present obligations.

*Distinguishing specified activities from requirements to incur eligible expenditure*

Specified activities are defined as “an action in a binding arrangement that must be completed by a transfer recipient”.

Eligible expenditure is defined as “an outflow of resources incurred in accordance with the requirements set out in a binding arrangement”.

Guidance in paragraphs 18 to 21 states that eligible expenditure is not specified activities. We also note the guidance in paragraphs AG25 to AG27 includes examples of specified activities and eligible expenditure.

The ED seems to require entities to make a clear distinction between specified activities and requirements to incur eligible expenditure. We question the need for this distinction, and note the following:

- When considering a number of examples in practice, we found it hard to distinguish between specified activities and eligible expenditure. They may be very similar in practice, and binding arrangements may not be specific, e.g. when compared to performance obligations, to require such a distinction.
- Both give rise to present obligations and are treated the same way for accounting purposes<sup>2</sup>.
- The later text in ED 71 is silent on specified activities and eligible expenditure, and only mentions present obligations, e.g. the section on transfers with present obligations (paragraphs 45 to 56). We also note that the illustrative examples are silent on whether a present obligation arises from specified activities or requirements to incur eligible expenditure. The illustrative examples are mostly retained from IPSAS 23 and deal with present obligations broadly.

We further note that paragraph AG26 requires a transfer provider to be able to confirm that all expenditure incurred was “eligible” and therefore the transfer recipient needs to keep appropriate documentation. Please refer to our concerns raised in specific matter for comment 3 of ED 72 related to monitoring requirements. We further note that this requirement is only included for eligible expenditure and it is unclear why it is not also included for specified activities.

**RECOMMENDATION:** We recommend that the clear distinction between specified activities and requirements to incur eligible expenditure be removed from ED 71. We also recommend the application guidance requiring record keeping be removed from ED 71.

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<sup>2</sup> Note our concern raised above that we do not believe specified activities and requirements to incur eligible on their own give rise to present obligations. A present obligation would only exist where there is a return obligation.



*Present obligations arising from binding arrangements*

Definition of binding arrangement

ED 71 determines that present obligations can only arise from binding arrangements. A binding arrangement is defined in ED 70 as “an arrangement that confers both enforceable rights and obligations on both parties to the arrangement”. We have raised concerns about the application of this definition - see our response to specific matter for comment 1 of ED 70.

In addition to the comment provided on ED 70, the guidance is unclear in ED 71 on how an entity applies this definition to conclude that transactions with present obligations result in rights and obligations for both the transfer provider and transfer recipient. In particular, the guidance is unclear on how an entity identifies the transfer provider’s rights in such an arrangement. For example, Entity A transfers CU100 to Entity B in an arrangement that requires Entity B to spend the funds on developing a sports field. Entity B has a right to receive CU100 and an obligation to develop a sports field. Entity A has an obligation to transfer CU100. For the model in ED 71 to work with the definition of a binding arrangement, we presume that Entity A’s right would be for Entity B to develop a sports field. This is however unclear. The transfer provider’s right may also not be clear or explicit in many arrangements in ED 71.

We are concerned that, because of the current definition of a binding arrangement, entities would be unable to identify a transfer provider’s rights and therefore conclude there is no binding arrangement. This illustrates our concern raised in the comment letter on ED 70 that the proposed definition of binding arrangement inappropriately tries to prescribe the characteristics of the transaction. These concepts should be separated.

The implication is that when entities conclude there is no binding arrangement, they would not progress to the next step to assess if present obligations exist in an arrangement (see “steps in ED 71” below). The transaction would therefore be in the residual category in ED 71 and revenue would be recognised in full when the asset is recognised. This could include arrangements that currently give rise to present obligations (conditions with return obligations) that may not meet the definition of a binding arrangement. Entities could revert from recognising a liability and revenue as conditions are satisfied, to recognising revenue in full when the asset is recognised.

Steps in ED 71

We found the illustrative examples unclear on how the requirements of ED 71 should be applied in practice. The flowchart illustrates how an entity first assesses whether an arrangement is binding, and then whether it contains present obligations. This is confirmed in the structure of ED 71. The examples may however give the impression that an entity first assesses whether there are present obligations in the arrangement, and this would inform whether the arrangement is binding. This could be a consequence of using the existing IPSAS 23 examples in ED 71, instead of developing new examples. We found the following examples to be particularly unclear:

Example	Background information	Issues identified
IE 10 Transfer of resources not binding	A transfer is made between government entities with no present obligations (IE 25).  The arrangement is not binding (IE 26).	There is no information in the example on how the conclusion was reached that the arrangement is not binding.

IE 12 Unenforceable transaction	Land is transferred to a university for the establishment of a campus. The agreement does not specify that the land must be used for that purpose or returned or another form of redress (IE 30).  Because the obligation is not enforceable, there is no liability (IE 31).	The example skips over the step of assessing whether there is a binding arrangement and assesses whether there are present obligations in the arrangement.
IE 13 Transfer with present obligations	A transfer is made between government departments with specifications on how the funds can be spent (IE 32).  The transfer recipient recognises a liability as the specifications are determined to be present obligations (IE 33).	The example skips over the step of assessing whether there is a binding arrangement and assesses whether there are present obligations in the arrangement.

RECOMMENDATION: We propose that the definition of a binding arrangement in ED 70 be amended, so that it does not require both rights and obligations for both parties to the arrangement.

In the event that the current definition is retained, we recommend that explicit guidance be provided on how an entity should assess a transfer provider's rights in transactions with present obligations, to enable entities to follow the steps in the ED correctly.

We further recommend that the illustrative examples be amended to clearly illustrate how the requirements and steps should be applied in ED 71.

#### *Distinguishing performance obligations from present obligations*

The accounting for revenue transactions is based on whether the transaction includes a performance obligation (and arises from a binding arrangement). It is therefore important for entities to correctly determine whether a transaction includes a performance obligation or a present obligation when the transaction arises from a binding arrangement. We are concerned about difficulties that stakeholders identified in making this distinction.

See our comment letter on ED 70, specific matter for comment 1.

#### *Consistent idea of present obligations in ED 71*

The *Definitions* section of ED 71 discusses present obligations in paragraphs 14 to 26. Paragraph 14 describes a present obligation as “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”. Paragraph 16 explains that the assessment of an outflow of resources includes incurring a penalty for breaching a binding arrangement, which is further discussed in paragraphs 19, 21, 23 and 24.

Present obligations are again discussed in paragraphs 47 to 52 as part of the section on *Transfers with Present Obligations*. We note that paragraphs 47 to 52 have largely been retained from IPSAS 23.

We have identified the following inconsistencies between the two sections:

- Paragraph 47 describes a present obligation as “a duty to act or perform in a particular way”. This differs from the description in paragraph 14: “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”.

- Paragraph 47 notes that “Present obligations may be imposed by requirements in binding arrangements... They may also arise from the normal operating environment...” This contradicts paragraphs 22 to 26 which highlight that present obligations can only arise from binding arrangements. The flowchart further illustrates how present obligations can only arise from binding arrangements.
- An example in paragraph 47 of present obligations “from the normal operating environment” that do not arise from binding arrangements is advance receipts. This is inconsistent with the *Definitions* section and the flowchart, where advance receipts not from binding arrangements would result in an entity recognising revenue when the asset is recognised, as there are no enforceable requirements on the use of the resources.

We question the need to discuss present obligations twice in the ED.

A further area in the ED where we believe the text is inconsistent is in the application guidance. Paragraphs AG58 to AG60 provide guidance on the breach of the terms and conditions of a binding arrangement. These paragraphs are inconsistent with the section on *Transfers with Present Obligations* as it appears to consider the breach of a binding arrangement to be a separate event. For example, the guidance in paragraph AG59 is to recognise a liability for the amount to be refunded, implying the outflow of resources from the breach was not initially considered to give rise to a liability.

RECOMMENDATION: We recommend that the duplicated discussion on present obligations in the *Transfers with Present Obligations* section be removed. Parts of this discussion that may be useful to retain should be combined with the discussion in the *Definitions* section. Paragraphs AG58 to AG60 should be reconsidered or amended, together with our concerns on what gives rise to present obligations in ED 71.

**Specific Matter for Comment 2:**

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 support the inclusion of a flowchart in ED 71. We do, however, have some reservations about its application to certain types of transactions.**

It is unclear how the flowchart applies to the following types of transactions:

- Binding arrangement assets and liabilities. See our response to specific matter for comment 6 below. We propose the requirements for binding arrangement assets and liabilities be deleted from ED 71.
- Advance receipts of taxes. An entity would have a liability until the taxable event has occurred (paragraph 96). However, because taxes do not arise from binding arrangements, the flowchart concludes that revenue is recognised when the asset is recognised. We propose that this should either be built into the flowchart, or taxes should be excluded from the flowchart.
- Transactions with components. We propose that the diagram explains the accounting of these transactions.

**Specific Matter for Comment 3:**

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 disagree that sufficient guidance exists to determine when a present obligation is satisfied and when revenue should be recognised.**

We note that the high-level principles from ED 70 have been included in ED 71 in paragraphs 57 and 58. However, the guidance from ED 70 paragraphs 32 to 37, which explains how an entity assesses whether performance obligations are satisfied over time or at a point in time, has not been included.

We do not believe entities would be able to determine whether present obligations are satisfied over time or at a point in time with the limited guidance in ED 71 at present.

Stakeholders did not express concerns about determining how present obligations are satisfied in IPSAS 23. We question the need to align the requirements to ED 70.

**RECOMMENDATION:** Consider retaining the existing guidance in IPSAS 23.

If the IPSASB believes that the same principles in ED 70 should be used to recognise revenue either over time or at a point in time for transactions with present obligations in ED 71, guidance should be included on how entities should make this assessment.

**Specific Matter for Comment 4:**

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 disagree that sufficient guidance exists to identify and determine how to allocate the transaction price to different present obligations.**

We note that the high-level principle from ED 70 on allocating the transaction price has been included in ED 71 in paragraph 80. We support the inclusion of this objective.

Paragraph 81 includes a description of a prescribed method that entities should use to allocate the transaction price, being *“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.”* We have the following concerns with this method:

- It is difficult to understand: No further guidance is provided in ED 71 on how an entity would apply this method. We think it is unclear and find it difficult to understand how the method is applied. We also believe it will lead to divergence in practice. For example, if the present obligation is the building of houses, one entity might use the number of houses to determine the percentage of revenue allocation, while the other might use the estimated costs of the houses.
- There is insufficient guidance in ED 71: Although we agree that the ED 70 method to allocate the transaction price based on stand-alone purchase prices is inappropriate for ED 71, there may be areas where guidance is provided in ED 70 that are also relevant to ED 71. For example, ED 70 provides guidance on the allocation of variable consideration in paragraphs 83 to 84. Guidance on the allocation of variable consideration may also be needed in ED 71.

We do not believe entities would be able to allocate the transaction price to present obligations in a meaningful way with the limited guidance included in ED 71 at present.

**RECOMMENDATION:** The proposed method to allocate the transaction price should be reconsidered. It is unclear and difficult to understand. We also recommend that additional guidance be considered on aspects such as variable consideration.

### **Specific Matter for Comment 5:**

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 the principle that contractual receivables are subsequently measured in accordance with the requirements of IPSAS 41. We question the need to be explicit about this in ED 71 paragraph 84(a) as these receivables are in the scope of IPSAS 41.**

**We do not support the subsequent measurement of non-contractual receivables in accordance with IPSAS 41 in paragraphs 84(b) and 85.**

We note that the same guidance is included in ED 70 paragraphs AG140 and AG141. Our comments below apply equally to ED 70.

#### *Inclusion and placement of guidance*

We question the inclusion of guidance on subsequent measurement of receivables in ED 71. Paragraph 3(g) excludes financial instruments and other contractual rights or obligations within the scope of IPSAS 41 from the scope of ED 71. It is therefore inappropriate to provide guidance on these items in ED 71 as they are excluded from the scope. We are therefore unsure about the question asked in this specific matter for comment on "*receivables within the scope of this [draft] Standard...*".

We further question the placement of the guidance in ED 71. See our response to specific matter for comment 7 below. It is unclear to which types of transactions the guidance applies. It currently appears to only apply to receivables from transactions with present obligations.

#### *Appropriateness of guidance*

[Note: We assume for the rest of our response to this specific matter for comment that the guidance is meant to apply to all types of transactions in the ED, i.e. transactions with present obligations, transactions without present obligations, and taxes.]

#### Nature of non-contractual receivables

The nature of receivables that are not in the scope of IPSAS 41 ("non-contractual receivables") is that they arise from mechanisms other than contracts, i.e. statutory mechanisms. They may therefore often be compelled transactions. In most instances, the entity has no or little discretion with whom it transacts, or the terms and conditions of the transaction, as these are specified in legislation or equivalent means. They are further often "non-exchange" in nature.

#### Information available for non-contractual receivables

Given the nature of non-contractual receivables, entities do not necessarily have detailed information about the counterparty, including the counterparty's credit risk. Furthermore, no or limited "market" information is available.

#### Proposed requirements and implications

ED 71 requires that non-contractual receivables meet the conditions of IPSAS 41 for an entity to apply amortised cost. Otherwise, the receivable should subsequently be measured at "fair value". The conditions in IPSAS 41 to measure assets at amortised cost are:

- (a) the [financial] asset is held within a management model whose objective is to hold [financial] assets in order to collect contractual cash flows; and
- (b) the contractual terms of the [financial] asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

We have the following concerns about these requirements:

- We are unsure how an entity would assess whether the amortised cost conditions are met for non-contractual receivables, given their nature. Entities do not typically have a management model and there are no contractual cash flows because the transaction does not arise from a contract. Furthermore, determining whether payments are solely of principal and interest has been complex for financial instruments, and would be even more so for non-contractual receivables. These difficulties would exist because the terms in statutory arrangements may not be consistent with those of a basic lending arrangement.
- Where the amortised cost conditions are met, we foresee a number of issues in applying amortised cost to non-contractual receivables, as discussed under “applying amortised cost” below.
- Where the amortised cost conditions are not met and “fair value” is applied, ED 71 is not explicit about what is meant with “fair value”. It is unclear whether this is the subsequent fair value measurement model in IPSAS 41, or something else. We are also unsure how entities would apply the IPSAS 41 fair value model, given the lack of a market, and therefore market information, for these types of transactions.

#### Applying amortised cost

##### Changes in estimates

Because of the nature of non-contractual receivables, often a considerable amount of reliance is placed on the use of estimates, both to identify when a transaction can be recognised as well as the amount at which it should be measured.

Where estimates are used to measure receivables under amortised cost, whenever the estimates are revised the receivable would need to be revised to reflect (a) the change in estimate, and (b) the discounting of the revised estimate. Particularly for taxes and fines, amortised cost may result in undue complexity. Furthermore, presenting revisions to discounting from changes in estimates of taxes and fines receivables may not provide users with appropriate information for accountability and decision-making purposes.

##### Interest

Stakeholders locally questioned the notion that there are “financing” elements in transactions such as taxes, fines and appropriations. For taxes and fines, they noted that the period of time allowed to settle any outstanding amounts should be seen as an administrative measure rather than extending credit. This is particularly important because in the time period allowed to settle these transactions, parties may be allowed to appeal the amount due or lodge disputes. For certain transactions there may be no settlement period and it is not practice to charge interest, for example, appropriations which are paid based on the overall cash available at national and provincial government (e.g. evenly on a quarterly basis).



## Impairment

A challenging part of measuring non-contractual receivables at amortised cost would be applying the expected credit loss (ECL) model. Although there are concessions in IPSAS 41 for receivables (e.g. allowing entities to always consider the lifetime expected credit losses and ignoring the requirements for purchased or originated credit-impaired financial assets) the requirements of the model are onerous. It requires entities to determine an unbiased and probability-weighted amount of impairment by evaluating a range of possible outcomes with the possible risk of default occurring as the weight. Time value of money is also considered. The model uses past, present and forecast data, as well as economic conditions of the borrower and general economic conditions.

It may be particularly difficult to apply the ECL model to non-contractual receivables because the transactions are often compulsory and entities may not have the same level of information about the counterparty's credit risk, especially current and forecast data. We further note that the model is relatively new in the private sector (effective 1 January 2018) and IPSAS 41 is not yet effective. It would therefore be difficult to apply as practice still needs to be established.

### 2017 Consultation Paper

We note that the IPSASB consulted on how to subsequently measure receivables as part of its Consultation Paper on *Revenue and Non-exchange Expenses* in 2017. Support was expressed for applying amortised cost to non-contractual receivables at that point in time.

We believe the response to the 2017 Consultation Paper may no longer be relevant in determining appropriate measurement requirements for non-contractual receivables. The amortised cost model changed when IPSAS 41 was published after the 2017 Consultation Paper. Amortised cost is more onerous and complex in IPSAS 41, specifically the ECL impairment model. It may be inappropriate to assume that the same support would be expressed for amortised cost in IPSAS 41.

**RECOMMENDATION:** We propose that guidance on transactions outside the scope of ED 71 be removed from the ED.

We propose the following regarding guidance on non-contractual receivables:

- The application of the guidance to the different types of transactions in ED 71 should be clarified.
- The “default” requirement to subsequently measure non-contractual receivables at amortised cost as in IPSAS 41 should be reconsidered. We do not believe this is appropriate given the nature of these receivables and the information that would be available for them. We further do not believe this provides relevant information to the users of financial statements. We suggest the IPSASB considers a more simplified approach. For example, a cost approach that uses only the information in the arrangement (which is likely statutory).
- If amortised cost is retained, guidance would need to be provided on how an entity assesses the IPSAS 41 conditions for non-contractual receivables, given their nature and information available for them. Further guidance would also be required on applying amortised cost where the conditions have been met, given the nature of the receivables and information available.

- If fair value is retained in instances where the amortised cost conditions are not met, the ED would need to be explicit about what is meant with fair value. Further guidance would also be needed on measuring non-contractual receivables at “fair value” given their nature and information available for them.

**Specific Matter for Comment 6:**

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 do not support the mirroring of the presentation and disclosure requirements from ED 70.**

*Presentation: performance obligation distinction*

Refer to concerns raised in the comment letter on ED 70, specific matters for comment 1 and 4.

*Presentation: binding arrangement assets and liabilities*

We note that the presentation requirements on binding arrangement assets and liabilities have been mirrored from ED 70, and are consistent with IFRS 15. We question the inclusion of these requirements in ED 71 for the following reasons:

- The presentation requirements in IFRS 15 are designed for executory contracts, i.e. an asset or liability is recognised when a party to the transaction performs. The nature of arrangements in ED 71 is different to the executory contracts envisaged in IFRS 15, and the revenue recognition model is different. Entities start by assessing whether they have an asset, irrespective of performance by them or the other party. Where present obligations exist for a transfer recipient, these present obligations do not arise because specific goods or services need to be provided to a purchaser in exchange for consideration. As there are no performance obligations in the transactions in ED 71, we question whether recognising “binding arrangement assets” and “binding arrangement liabilities” in all instances are appropriate for these transactions.
- We question the relevance of information provided to users of financial statements by requiring the presentation of binding arrangement assets and liabilities. It is unclear what they represent in the context of ED 71.
- Refer to our response to specific matter for comment 4 of ED 70 for concerns raised about the requirement to separate binding arrangement assets from receivables. The same concerns apply in ED 71.

**RECOMMENDATION:** We recommend the presentation requirements for binding arrangement assets and liabilities be removed from ED 71.

*Disclosure*

We support the inclusion of a disclosure objective. We also support the disclosure requirements related to significant judgements. This is an area of improvement in financial statements. We agree that more specific requirements are necessary to improve the information disclosed in financial statements.

We have concerns in the following areas regarding the balance of guidance on the measurement of transactions compared to the disclosure requirements:

- Determining the timing of satisfaction of present obligations. For present obligations satisfied over time, entities should disclose the methods used to recognise revenue and an explanation of why the methods were used. For present obligations satisfied at a point in time, entities should disclose the significant judgements made in evaluating when a present obligation is satisfied. No guidance is provided in ED 71 on how to make these assessments.
- Determining the transaction price and the amounts allocated to present obligations. Entities should disclose the methods, inputs and assumptions used to allocate the transaction price, while no guidance is provided in ED 71 on this.

**RECOMMENDATION:** Refer to our comment on specific matters for comment 3 and 4 above. The balance may be achieved through added guidance in ED 71.

Stakeholders noted further concerns with the proposed disclosure requirements for transactions with present obligations that have been mirrored from ED 70 for transactions with performance obligations. We question the appropriateness of such extensive requirements for these types of transactions, as well as the relevance of the information to users. For example, the requirements in paragraphs 143 to 145 on binding arrangement balances and paragraph 146 on present obligations were not required in IPSAS 23 for transactions with present obligations from conditions.

Stakeholders noted that they do not have the capability to generate the information required from their existing systems. Extensive resources would be required to produce the information outside of their systems, or to upgrade their systems.

**RECOMMENDATION:** We recommend that the disclosure requirements for transactions with present obligations (mirrored from ED 70) be reconsidered. The informational value to users, together with the resources required from entities to disclose this information, should be considered.

#### Other comment on disclosure

- Services in-kind

We are of the view that services in-kind are recognised when they meet the definition and recognition criteria of an asset and are significant to an entity's service delivery objectives.

We do, however, support that ED 71 requires entities to disclose qualitative and quantitative information about services in-kind that have been recognised, which is not required in IPSAS 23.

- Practical expedient

We note that ED 70 requires disclosure of practical expedients used, for example on the existence of a significant financing component. This practical expedient also exists in ED 71, but no specific disclosure is required in ED 71. We propose that it be added to ED 71.

- ED 72 contingent liabilities

Refer to our response to specific matter for comment 8 of ED 72. We question the appropriateness of paragraph 150 of ED 72 which indicates that an entity should consider whether the disclosure of a contingent liability is appropriate for appropriations subject to authorisation which have not yet been authorised. Although we note that an equivalent disclosure of a contingent asset is not included in ED 71, we are concerned that a transfer recipient who is familiar with ED 72 will see the requirement in ED 72 for a transfer provider as an indication that they as the transfer recipient should disclose a contingent asset. We propose the disclosure requirement be removed from ED 72.

- Compelled transactions

Although we support the disclosure requirements that have been added for compelled transactions, we have concerns about the potential implications on the collectability of receivables. Refer to our response to specific matter for comment 5 of ED 70 in this regard.

We further note paragraph 147 duplicates the requirements of paragraph 137. Consider removing duplicated requirements.

### **Specific Matter for Comment 7:**

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 do not support the structure of ED 71 as the requirements are unclear in some areas.**

#### *Recognition of assets arising from resource inflows*

It is unclear if this section applies to all types of transactions in ED 71, including taxes and other compulsory contributions and levies. Some parts of the text in paragraphs 32 to 44 refer to taxes. However, the section on taxes from paragraph 89 onwards also discuss the recognition of assets in respect of taxes.

#### *Placement of measurement guidance*

We note that the measurement requirements are included under transfers with present obligations (paragraphs 59 to 79). These measurement requirements appear to also apply to other transactions in the ED as follows, but this is not immediately clear:

- Revenue without present obligations (paragraph 88) refers to paragraph 59. Because paragraph 59 includes a reference to paragraphs 60 to 79, we assume that all the measurement requirements for transfers with present obligations apply to transfers without present obligations, but this is unclear.
- Assets arising from taxation transactions (paragraph 97) refers to paragraph 60 on transaction price and mentions that the method in paragraph 67(b) is appropriate for estimating variable tax revenue. It is unclear whether all of the requirements in paragraphs 59 to 79 apply to the measurement of taxes.
- Subsequent measurement of receivables is included in paragraphs 84 and 85 under revenue with present obligations. As noted in specific matter for comment 5 above, the application of this guidance to other transactions in the ED is unclear.

#### *Application guidance in core text*

We note that the ED includes guidance on the application of the principles and requirements to specific transfers. For example, capital transfers, pledges, advanced receipts of transfers and concessionary loans. The guidance seems inappropriate for the core text.

**RECOMMENDATION:** The guidance on recognition of assets should either all be combined in one section upfront, or clearly distinguished for the different types of transactions in the ED. The application of the measurement guidance to all transactions in the ED should be clarified. We further recommend that application guidance should be relocated to Appendix A and should not be included in the core text.

## **ANNEXURE B – OTHER SIGNIFICANT ISSUES**

### **1. Definition of taxes**

Although we note that the definition of taxes remains unchanged from IPSAS 23, consider whether the definition could include, rather than exclude, penalties. For example, penalties in relation to breaches of the tax legislation for under declaration of tax. The tax and penalties imposed should be treated the same for accounting purposes as they have the same economic characteristics.

We note that guidance is provided on expenses paid through the tax system. Although these expenses are not revenue transactions, it is unclear how an entity should recognise and measure them. For example, if an entity should apply another IPSAS such as IPSAS 42 or IPSAS 19 to determine a liability for these expenses, it could be helpful to add such guidance.

**RECOMMENDATION:** We recommend that all tax related penalties, etc. be included in the definition of taxes and that non-tax related penalties and fines should be separately defined as breaches of any non-tax legislation. Additional guidance on the recognition and measurement of expenses paid through the tax system would also be helpful.

### **2. Assessing whether an inflow gives rise to an asset**

We note that paragraph 40 has been aligned to the requirement in ED 70 paragraph 8(e). A transfer recipient will consider the transfer provider's ability and intention to pay when considering whether the inflow of resources is probable. Paragraph 40 also (as in ED 70) refers to consideration that may be variable, including from implicit price concessions.

We note that further guidance may be needed in ED 71 as a result of the relationship between the transfer provider and the transfer recipient. The relationship of the parties may impact on the assessment required by paragraph 40, as well as the variability of the "transaction price". For example, a national government providing a transfer to provincial government. By virtue of the relationship, the national government is often able to amend or withdraw the transfer before the cash is paid.

#### *Probable inflow of resources: distinction with impairment loss assessment*

Paragraph 61 is clear that credit risk is not considered when determining the transaction price. Refer to our response to specific matter for comment 5 of ED 70. We are concerned about entities' ability to distinguish the assessment of the transfer provider's ability and intention to pay from an impairment assessment. Because similar requirements to ED 70 are included in ED 71, our concerns apply equally to ED 71.

#### *Probable inflow of resources: Implications of not meeting the requirement*

We are concerned about the implications of paragraphs 41 to 43 on *Subsequent considerations of asset recognition criteria* where the asset recognition criteria are not met by applying paragraph 40. As noted in our comment letter on ED 70, entities could go from recognising revenue in full to only recognising revenue when cash is received. We are particularly concerned about these requirements for compelled transactions. We note that additional disclosure requirements on compelled transactions have been added to ED 71 (as in ED 70), but do not agree that additional disclosure would compensate for the information lost to a user by an entity not recognising these transactions.

### Illustrative examples

We further note that the illustrative examples do not illustrate the requirements of the ED. We have the following comment on the illustrative examples:

Example	Background	Issues identified
IE 18	<p>A fine of CU50 million is imposed on a corporation. The corporation is able to pay the amount, but not willing to do so and appeals the fine.</p> <p>Based on historical outcomes of appeals, the entity recognises a receivable and payable of 75% of the fine.</p>	<p>The example does not illustrate how the requirements of the ED have been applied and is potentially inconsistent with the ED:</p> <ul style="list-style-type: none"> <li>• The corporation is not <i>willing</i> and able to pay the fine. Therefore, the recognition criteria (paragraph 40) are not met and no receivable should be recognised.</li> <li>• Paragraphs 41 to 43 should be applied to continue to reassess if the criteria are subsequently met, or revenue could potentially be recognised on the cash basis.</li> <li>• If the entity has granted an implicit price concession, making the transaction price variable, and therefore is willing to accept a lower amount – this is not mentioned and should be clarified. It should also be clear that the recognition criteria are met after assessing an implicit price concession.</li> </ul>
IE 20	<p>A universal aid agency invoices various governments for their portion of the agency’s budget they are required (per binding arrangements) to fund.</p> <p>The agency receives the transfers from some governments before they are entitled to it, other governments during the year, and a minority of governments remain outstanding at reporting date (and will likely never pay).</p>	<p>The example does not illustrate how the requirements of the ED have been applied. We do not believe that paragraph IE50 is consistent with the ED in the following respects:</p> <ul style="list-style-type: none"> <li>• An asset is recognised for the governments that pay during the year “as and when the funding is received”, i.e. on the cash basis. This is inconsistent with ED where an asset is recognised when the definition and recognition criteria are met. This would be on day 1 of the reporting period when the agency is entitled to the resources. If other factors are at play that leads to cash accounting (i.e. the recognition criteria are not met), this should be explained.</li> <li>• The agency discloses that an allowance for doubtful debts was established for those entities that have not paid. An allowance for doubtful debts can only be established where a receivable was recognised. No receivable was recognised for these amounts because the criteria were not met.</li> </ul>



RECOMMENDATION: The use of ED 70 “ability and intention to pay” in ED 71 in relation to assessing whether an inflow meets the recognition criteria of an asset should be reconsidered. If retained, we believe guidance is needed to distinguish the assessment from an impairment loss assessment. We further recommend that the illustrative examples be updated to align to the requirements of the ED.

### 3. Measurement requirements, including for taxes

We note that the measurement requirements in ED 71, from paragraphs 59 to 77, are the same requirements as in ED 70 to determine the transaction price for transactions with performance obligations. These requirements are aligned to the requirements of IFRS 15 and what is applied in the private sector. Paragraphs 59 to 77 set the requirements to measure an asset in a transaction with present obligations. We note that this guidance also applies to transfers without present obligations (paragraph 88 refers entities to paragraph 59), and for taxes (paragraph 97 refers entities to paragraph 60).

We question the appropriateness of this guidance in the public sector. We are particularly concerned about the application of the guidance for taxes for the following reasons:

- Applying “transaction price” to taxes changes the measurement of taxes compared to IPSAS 23. IPSAS 23 requires an entity to measure tax revenue using a “best estimate”. This could have resulted in an entity only developing one possible outcome for tax collection. We note that the ED also refers to assets arising from taxation transactions being measured at the “best estimate” of the inflow of resources (paragraph 97). However, paragraph 97 refers entities to the mostly likely amount method in paragraph 67(b). Applying paragraph 67(b) will require entities to develop a model to identify the most likely amount in a range of possible amounts. Our concerns with the proposal are:
  - Developing multiple scenarios for tax revenue will be extremely onerous and unnecessary. The nature of tax revenue is such that the amounts or basis to calculate amounts are set in legislation. This includes potential variable consideration such as discounts and rebates. Any further amendments to the amount receivable result from subsequent credit risk assessments which should not be part of the initial assessment of the transaction price.
  - The most likely amount method is described to be most appropriate where only two possible outcomes exist, e.g. either an entity meets a certain target or not. That is not the case with taxes. We therefore question why the ED indicates this as the best method to use for taxes.
- Paragraph 68 requires entities to consider all the information (historical, current and forecast) that is reasonably available to it. It further confirms paragraph 67 that an entity is required to identify a reasonable number of possible amounts in making the estimate. IPSAS 23 does not explicitly require entities to consider current and forecast data. This adds to the complexity and how onerous it would be to develop a model to estimate variable consideration for tax revenue.
- As indicated in paragraph 101, constraining estimates of variable inflow also apply to taxes. We are concerned that with the more complex and onerous measurement requirements, entities will conclude that they are unable to recognise variable consideration as a result of

the constraints. Since taxes are a major source of government revenue, we are concerned that this could result in a significant reduction in government revenue recognised.

Stakeholders further noted that the illustrative example 3 on the measurement of tax revenue is unhelpful as it does not illustrate the complexities that would exist in measuring taxes.

**RECOMMENDATION:** We propose that the accounting for tax revenue should be kept closely aligned with the principles established in IPSAS 23.

Should the requirements from IFRS 15 on transaction price be retained, we suggest that the application guidance for tax revenue indicate that an entity need not apply either of the methods in paragraph 67 where there are variable inflows but can develop a single best estimate.

#### **4. Capital transfers**

We question the need for specific guidance in ED 71 on capital transfers. We believe the principles should apply equally to all transfers, whether they are operational or capital expenditure. Our concerns about the guidance included in ED 71 are discussed below.

##### Definition

We do not agree with the definition of a capital transfer, read with the guidance in paragraph AG24, that all capital transfers do not impose performance obligations and give rise to assets controlled by the entity. We perceive the definition to create a rule, instead of allowing entities to apply the principles.

“Capital transfers” are generally understood to be a transfer of funds for capital purposes, rather than operational. The constructed asset may upon completion be transferred to a third party. For example, a Department of Public Works receives a grant from national government to construct a school for the Department of Health.

We further note that paragraph AG24 may give the incorrect impression of how performance obligations are assessed because it does not deal with the assessment comprehensively. For example, it does not discuss whether there are specific and distinct goods or services promised.

##### Application guidance

We question the need for the guidance on capital transfers in paragraphs 108 and 109 in its current form. We do not think it adds any value as it does not describe how the principles apply to capital transfers. It also seems out of balance compared to the discussion in the basis for conclusions in paragraphs BC19 to BC23.

**RECOMMENDATION:** We recommend the definition and guidance in paragraphs AG24, 108 and 109 be deleted.

Should the guidance be retained, we propose that the current definition and guidance in paragraph AG24 be reconsidered as it is not aligned to current understanding and practice. The status of paragraphs 108 and 109 should be reconsidered; it would be more appropriate as application guidance. The nature of guidance provided should also be reconsidered. To be useful, the guidance should explain how the principles of ED 71 apply to capital transfers.

## 5. Illustrative examples

We note that the illustrative examples in ED 71 are mostly retained from IPSAS 23. Amendments are necessary to illustrate the complexities that have been introduced in the ED when compared to IPSAS 23. It would assist stakeholders with implementing the requirements if illustrative examples could be provided on complex aspects of the ED, including:

- Identifying a transfer provider's right that would result in an arrangement meeting the definition of a binding arrangement.
- Identifying specified activities and requirements to incur eligible expenditure, and distinguishing them from performance obligations. The distinction with performance obligations could be particularly difficult to make where goods or services are provided to third parties.
- Measurement of transaction price with variable consideration, including for taxes.

RECOMMENDATION: We recommend that the illustrative examples be updated and expanded to illustrate how the requirements of the ED should be applied.
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## ANNEXURE C – DRAFTING AND OTHER COMMENTS

### General comment

#### *(1) Structure of ED 71*

The order of the application guidance, basis for conclusions and illustrative examples are not aligned to the order of requirements in the core text. We suggest this be aligned. For example, in the application guidance, specified activities should be discussed before eligible expenditure; measurement of transferred assets should be included before determining the transaction price. Paragraphs AG58 to AG60 on breach of the terms and conditions of a binding arrangement seem out of place.

It is further unclear how some of the discussions under other transfers in paragraphs AG34 to AG54 relate to the core text.

#### *(2) Assessing whether an inflow gives rise to an asset - Conceptual Framework or IPSAS 1?*

ED 71 requires entities to recognise an asset from an inflow of resources when the definition and recognition criteria are met (paragraph 31). Paragraph 32 refers to the definition of an asset in IPSAS 1 on *Presentation of Financial Statements*, being a resource controlled by an entity as a result of past events, and from which future economic benefits or service potential are expected to flow to the entity. Paragraph 33 contains the recognition criteria aligned to IPSAS 23, being that it should be probable that the future economic benefits or service potential associated with the asset will flow to the entity and the value can be measured reliably.

The IPSASB's Conceptual Framework includes an updated definition for an asset, being a resource presently controlled by the entity as a result of a past event, and recognition criteria, being that an item satisfies the definition and can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in general purpose financial reports.

We note that the educational material made available with ED 71 quotes the definition and recognition criteria from the Conceptual Framework. This differs to the content of ED 71.

We are therefore unsure about the IPSASB's intention with regards to the definition and recognition criteria. Using the updated definition and recognition criteria from the Conceptual Framework is plausible as the Conceptual Framework is used as the basis to set standards. Presumably standard-level requirements are aligned to the updated Conceptual Framework over time and this project is an opportunity to do so for revenue standards.

We have assumed in providing further comment on ED 71 that the IPSASB's intention is as indicated in ED 71, i.e. the definition and recognition criteria from existing IPSAS are applied, and not the criteria from the latest Conceptual Framework.

We note, however, that if the IPSASB intended to use the criteria from the latest Conceptual Framework, the probability assessment in paragraph 40 is not explicitly required and may rather impact on the measurement of the item. Refer to issue 2 *Assessing whether an inflow gives rise to an asset* in Annexure B above where we have expressed concerns with paragraphs 40 to 43. Should the asset definition and recognition criteria be updated, these paragraphs would need to be amended.

### (3) Other general comment

- Goods in-kind: The distinction between an entity receiving goods in-kind (paragraphs AG50 to AG54) and receiving non-cash transfers (paragraphs 78 and 79) is unclear. If these are intended to be the same, it would be helpful if they are linked. Otherwise a clearer distinction is required.
- With the proposal to replace the existing exchange/non-exchange distinction with whether a transaction has performance obligations, we propose that a thorough review be done of existing literature to identify references to exchange/non-exchange transactions that may become irrelevant. For example, we have noted some text in ED 71 that would require amendment, such as paragraph 3(c) that excludes from the scope of the standard a public sector combination that is a non-exchange transaction. There is also text in ED 71 retained from IPSAS 23 where the terms “exchange/non-exchange revenue” have simply been replaced with “revenue with/without performance obligations”. In some instances, this requires redrafting, e.g. in paragraph 137.
- ED 71 replaces “conditions” that gave rise to present obligations in IPSAS 23 with “specified activities” and “eligible expenditure”. A thorough review of the IPSAS literature is required to ensure references to “conditions” are amended where necessary. We have identified areas in ED 71 that still refers to “conditions”.

### Specific comment

Paragraph	Comment
10	Definitions: we note that there is no definition for “present obligation”, although “specified activities” and “eligible expenditure” are defined. Consider elevating paragraph 14 to the definitions and clarifying that it is for purposes of this ED.
Flowchart (after 31)	<ul style="list-style-type: none"><li>• The first block indicates “does the inflow...”: consider changing this to “resource” as there may not be a flow (e.g. a right to receive a resource when a binding arrangement is concluded).</li><li>• We note that a similar diagram is not included in ED 70. It may be useful to develop a diagram for ED 70 explaining the linkages with ED 71.</li></ul>
41	<ul style="list-style-type: none"><li>• Consider if the heading “subsequent consideration of asset recognition criteria” is appropriate, as it mostly relates to the treatment of the credit leg, i.e. revenue or liability.</li><li>• Consider clarifying in paragraph 41 that this relates to where the criteria in paragraph 40 are not initially met.</li></ul>
55	The paragraph can be deleted. It is located under “transfers with present obligations” but deals with transfers without present obligations (dealt with in the next section) and contributions from owners (scoped out of ED 71).
56	This paragraph is related to the next section. Since the content is repeated in paragraphs 57 and 58, it can be deleted.

60	Measurement of revenue: consider a subheading for “cash transfers” before paragraph 60 (aligned to heading “non-cash transfers” before paragraph 78) to clarify the requirements.
66	The paragraph states an inflow may be explicitly stated in laws, regulations, or a binding arrangement. Reconsider this in light of (a) laws and regulations may also give rise to binding arrangements, and (b) refer to our response to specific matter for comment 1 of ED 70 for concerns with the definition of binding arrangements.
94	The heading before paragraph 94 should include taxes as the paragraphs under the heading also discuss taxes.
107	<ul style="list-style-type: none"> <li>• It is unclear what the purpose of the paragraph on transfer revenue is and it is difficult to understand how it interacts with the ED. Specific matter for comment 2 of ED 70 explains why the IPSASB did not define “transfer revenue”. We do not think it is necessary to provide guidance specifically for “transfer revenue” and propose that the paragraph be deleted.</li> <li>• We also note example 25 illustrates disclosure and includes a category for “transfer revenue”. We do not think this is appropriate given the IPSASB’s conclusion noted in specific matter for comment 2 of ED 70.</li> </ul>
110 to 116	We question the appropriateness of some of the paragraphs related to services in-kind in the core text, for example paragraph 115 seems more appropriate for the basis for conclusions (first part) and as application guidance (last part).
121	We note that the equivalent paragraph is bold in ED 70.
152(b)	The disclosure requirement has been included from ED 70 and refers to a transfer of goods or services. This is not relevant to ED 71.
AG58 to AG60	Paragraph AG58 notes that the accounting treatment depends on three things discussed in (a) to (c). We note that only (b), being when the breach occurred, is addressed in the further paragraphs AG59 and AG60.
	It is unclear how the guidance in paragraph AG60 should be applied to know whether a breach has resulted in a change in accounting estimate, error, or separate past event. We think linking this guidance more clearly to the three things in paragraph A58 could clarify this.
	Paragraph AG60(c) is unclear about why a breach would be a separate past event when the amount previously recognised is not estimated.