

Meeting: IPSASB Consultative Advisory Group
Meeting Location: Kuala Lumpur, Malaysia
Meeting Date: December 03, 2018

Agenda Item **7**

For:
 Approval
 Discussion
 Information

GRANTS AND OTHER TRANSFERS (REVENUE AND NON-EXCHANGE EXPENSES)

Project summary	<p><i>Revenue</i></p> <p>The aim of this project is to develop one or more IPSASs covering revenue transactions (exchange and non-exchange) in IPSASs.</p> <p>The scope of this project is to develop new standards-level requirements and guidance on revenue to amend or supersede that currently located in IPSAS 9, <i>Revenue from Exchange Transactions</i>; IPSAS 11, <i>Construction Contracts</i>; and IPSAS 23, <i>Revenue from Non-exchange Transactions (Taxes and Transfers)</i>.</p> <p><i>Non-Exchange Expenses</i></p> <p>The aim of the project is to develop a standard(s) that provides recognition and measurement requirements applicable to providers of non-exchange transactions, except for social benefits.</p>	
Meeting objectives	Topic	Agenda Item
Discussion Items	<p>CAG input into:</p> <ul style="list-style-type: none"> Approach to accounting for transactions with time requirements 	7.1
Other supporting items	Appendix A: IPSASB Due Process Checklist – Revenue and Non-exchange Expenses	7.2
	Appendix B: Links to Other Documents	7.3

Agenda Item 7.1

Approach to Accounting for Transactions with Time Requirements

Background - Summary from June 2018 meeting

1. The Consultative Advisory Group (CAG) last provided input into the Revenue and Non-Exchange Expenses projects at the June 2018 meeting in Toronto.
2. At this meeting, staff asked the CAG to provide input on three aspects of the revenue project:
 - (a) Whether the IPSASB should adopt a public sector performance obligation approach (PSPOA) for transactions identified as Category B in the Consultation Paper (CP), *Accounting for Revenue and Non-Exchange Expenses*. The CAG agreed that this approach should be pursued and at the IPSASB's June 2018 meeting the Board agreed.
 - (b) Whether the concept of a performance obligation should be expanded beyond a 'transfer of goods and services' so that the PSPOA could potentially be used to account for some grants such as capital grants. The CAG agreed that this approach should be considered. At the moment the IPSASB have tentatively decided to retain the concept of a performance obligation to transfer goods and services to fulfill a performance obligation but how far the concept of a performance obligation can be expanded will be addressed further at a future meeting.
 - (c) Whether the current voluntary recognition of services in-kind should be altered to mandate the recognition of such services. The CAG did not agree that recognition of services in-kind should be mandated and the IPSASB agreed. Therefore, recognition of services in-kind will remain voluntary but a greater emphasis will be placed on disclosing such services particularly if an entity has a great reliance on them to undertake its operations.
3. There are still a number of areas that have to be discussed by the IPSASB before an exposure draft is issued, these being:
 - (a) Licenses and fines;
 - (b) Subsequent measurement of receivables,
 - (c) Taxes with long collection periods;
 - (d) Capital grants (if a possible revised definition of a performance obligation does not allow for these such grants to be accounted for under the PSPOA); and
 - (e) Transactions with time requirements.
4. Although there is still much to do the project is still on track to have an exposure draft to be approved for issue at the September 2019 IPSASB meeting.
5. At the June 2018 meeting, the CAG was also asked to provide input on two aspects of the non-exchange expenses project:
 - (a) Whether the IPSASB should also adopt the PSPOA for some non-exchange expenses. The CAG saw the benefits of adopting the PSPOA and thus achieving symmetry with the accounting for revenue, but cautioned that the decision should be based on the Conceptual Framework. In this context, the CAG questioned whether the grantor would have an asset. The IPSASB has tentatively concluded that the grantor would have an asset for the goods or services to be transferred to a third party, and that the use of the PSPOA is therefore appropriate.

- (b) How best the IPSASB could provide guidance on collective services. There was no consensus on how guidance on collective services should be provided. CAG members supported a number of options. The IPSASB has subsequently agreed to develop an Exposure Draft on *Collective and Individual Services and Emergency Relief*. The ED will propose providing the guidance as amendments to IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* and is expected to be approved at the IPSASB's December 2018 meeting.
6. The IPSASB will be discussing a number of issues in developing a further ED on non-exchange expenses, including:
- (a) Subsequent measurement of payables;
 - (b) Accounting for non-exchange expenses without performance obligations, in particular:
 - (i) Capital grants (if not included in a revised definition of a performance obligation); and
 - (ii) Transactions with time requirements
7. These issues are related to those being discussed in the *Revenue* project. The IPSASB will discuss the issues for both projects at the same meetings, to ensure that the conceptual bases used in both projects are consistent. This does not necessarily mean that the accounting will be symmetrical.

Time Requirements

Revenue

8. For this CAG meeting, staff would like to seek input into possible accounting approaches for transactions with time requirements.
9. A time requirement was described in the CP as: "a provision in an agreement indicating the resource provider's intention that the resources are to be used by the resource recipient in a specific time period or periods. However there is no explicit return obligation on the resource recipient if the resources are not used in those periods". While this was the description in the CP staff consider that whether or not there is an explicit return obligation does not affect the current accounting treatment for transactions with time requirements.
10. Transactions with time requirements were identified as one of the IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* applications issues identified in the CP. In particular, preparers considered that IPSAS 23 was too restrictive in not allowing revenue to be recognized over time when funding is received for a special purpose. Preparers consider that this may hinder the usefulness of the information provided.
11. This restriction is considered problematic because, firstly if revenue intended to be used over a number of financial periods is recognized at the beginning of the first period then an entity may show a surplus in the Statement of Financial Performance for that first year and then a deficit in the following years.
12. The second issue is that if revenue is recognized immediately, the donor's intention – that the funds be used for a number of periods – is not conveyed to the user of the financial statements. Although the intentions for the use of such funding can be addressed in the notes to the financial statements, the face of the financial statements may be misleading.

13. These issues identified by stakeholders illustrate the tension between different parts of the Conceptual Framework. The current accounting treatment in IPSAS 23, which requires revenue to be recognized immediately, is consistent with the Conceptual Framework’s element definitions, specifically the definitions of liabilities and revenue. However, some stakeholders argue that strict compliance with these definitions results in financial statements that do not meet the objectives of financial reporting or the qualitative characteristics (QCs), in particular faithful representation and understandability.
14. In providing advice to the IPSASB on transactions with time requirements, the CAG is asked to consider whether the public interest is best served by compliance with the element definitions or by departing from those definitions to meet better the objectives of financial reporting and the QCs.
15. To address this application issue the CP proposed four options for accounting for transactions with time requirements.
 - (a) Require enhanced display/disclosure;
 - (b) Classify time requirements as a condition;
 - (c) Classify transfers with time requirements as “other obligations”; or
 - (d) Recognize a transfer with time requirements in net assets/equity and recycle through the statement of financial performance.
16. The table below provides a numerical overview of respondent’s preferences.

Option (as in paragraph 10 above)	Number of Responses	% of Responses
(a) Require enhanced display and/or disclosure	7	18%
(b) Classify time requirements as a condition	2	5%
(c) Classify transfers with time requirements as ‘other obligations’	6	16%
(d) Recognize in net asset/ equity and recycle	10	26%
Proposes Alternative Option	2	5%
None of the options	1	3%
Response not clear	3	8%
No comment	7	18%
Total	38	100%

17. As indicated respondents had no clear preference on how the requirements for transactions with time requirements should be updated to provide better information. Therefore, staff are of the view that three out of the four options should be evaluated further. The approach staff does not consider warrants further evaluation is Option (b) – Classify time requirements as a condition. Given the Board’s decision to proceed with the PSPOA, staff consider that because a condition in IPSAS 23 is analogous to a performance obligation in the PSPOA this option is no longer viable.
18. Following is a brief overview of the advantages and disadvantages of options (a), (c) and (d) above. These advantages and disadvantages have been drawn from respondent comments as well as staff views.
19. Further, to understand better how these approaches would impact how the information provided to users, an illustration of what the financial statements would look if a particular option was adopted is presented in the accompanying Appendix.

Option (a) – Enhanced display and/or disclosure

Advantages	Disadvantages
<ul style="list-style-type: none"> • Stays true to the definition of elements in the Conceptual Framework. • The current IPSAS literature does not prohibit this option. It is not that different from the current disclosure requirement under IPSAS 23.106(d). • Gives the recipient a method of communicating its performance story • Help educate users not to focus on the surplus/deficit but to look at what makes up the surplus/deficit. 	<ul style="list-style-type: none"> • Does not show on the financial statements that the recipient will use the resources in future periods. • Does not resolve the mismatch between the revenue recognition and when the resources are consumed. • This is suggesting reserve accounting which could be seen as a step backwards for some jurisdictions which have moved away from this.

20. The impact on the financial statements of this option is shown below (assuming a grant is paid in year 1 and used in years 2–4).

	Year 1	Year 2	Year 3	Year 4
Statement of Financial Performance				
Revenue	Recognized in full on receipt	–	–	–
Expense		Recognized as incurred	Recognized as incurred	Recognized as incurred
Statement of Financial Position				
Cash/Bank	Debit on receipt	–	–	–
Accumulated Surplus or Deficit (Restricted)	At year end, displayed or disclosed as restricted	Reduced as grant is used	Reduced as grant is used	Reduced as grant is used

Option (c) – Classify transfers with time requirements as ‘other obligations’

Advantages	Disadvantages
<ul style="list-style-type: none"> • Consistent with the Conceptual Framework because this transaction is an economic phenomenon that does not meet the definition of any element but is recognized in the financial statements to meet the objectives of financial reporting. • Addresses constituents’ concerns about the mismatch between revenue recognition and when the resources are consumed • Users can see information about flows relating to future periods. 	<ul style="list-style-type: none"> • Some argue that time requirements are deferrals and are not economic phenomena that should be treated differently from other revenue transactions with no performance obligations but with stipulations over use. • This could lead to other deferrals being on the balance sheet even though they don’t meet the definition of a liability.

21. The impact on the financial statements of this option is shown below (assuming a grant is paid in year 1 and used in years 2–4).

	Year 1	Year 2	Year 3	Year 4
Statement of Financial Performance				
Revenue	–	Recognized to match grant used	Recognized to match grant used	Recognized to match grant used
Expense		Recognized as incurred	Recognized as incurred	Recognized as incurred
Statement of Financial Position				
Cash/Bank	Debit on receipt	–	–	–
Other Obligations	Credit on receipt	Reduced as revenue is recognized	Reduced as revenue is recognized	Reduced as revenue is recognized

Option (d) – Recognize a transfer with time requirements in net assets/equity and recycle through the statement of financial performance

Advantages	Disadvantages
<ul style="list-style-type: none"> Some consider this best represents the economic reality in terms of cash flows. Consistent with the Conceptual Framework as the Framework does not require certain elements to be linked to particular financial statements. The use of net assets/equity is already used in other IPSAS such as IPSAS 29 which requires gains/losses of the hedging instrument in cash flow hedges to be recognized in net assets/equity although it is acknowledged that this is in the circumstances of unrealized gains/losses whereas for transactions with time requirements the inflow has already materialized. 	<ul style="list-style-type: none"> Some consider this could misrepresent the recipient's financial performance, for example it would show that the recipient is not better off from a performance perspective even though there has been an increase in net assets. Deferring resources in net assets/equity may be difficult to understand as it is a change from current practice.

22. The impact on the financial statements of this option is shown below (assuming a grant is paid in year 1 and used in years 2–4).

	Year 1	Year 2	Year 3	Year 4
Statement of Financial Performance				
Revenue	–	Recognized to match grant used	Recognized to match grant used	Recognized to match grant used
Expense		Recognized as incurred	Recognized as incurred	Recognized as incurred
Statement of Financial Position				
Cash/Bank	Debit on receipt	–	–	–
Restricted Reserves (in Net Assets/Equity)	Credit on receipt	Reduced as revenue is recognized	Reduced as revenue is recognized	Reduced as revenue is recognized

Question for the CAG

Given that the objective of financial reporting is to provide information about an entity to users for accountability and decision making, which of the above approaches does the CAG consider best meets this objective?

Expenses

23. The issues regarding accounting for non-exchange expense transactions with time requirements are similar to those discussed above for revenue.
24. Currently there is no IPSAS that addresses these transactions. Applying IPSAS 23 by analogy to expenses would result in an expense being recognized immediately unless the arrangement included a return obligation.
25. A similar conclusion would be reached by applying the Conceptual Framework. A grantor would have lost control of the cash it transferred in respect of the grant. An expense with time requirements would not involve the transfer of specific goods or services to third parties, and therefore the grantor would not recognize any other asset. Consequently, the grantor would recognize an expense on day one.
26. Although the CP did not discuss time requirements in the context of expenses, some stakeholders argue recognizing an expense on day one does not satisfy the objectives of financial reporting or the QCs because the financial statements would not provide information on the grantor's intention. Some stakeholders also argue that recognizing an expense on day one overstates expenses in the first reporting period, and understates them in the remaining periods. These arguments mirror those made in respect of revenue.
27. Similarly, if the IPSASB were to decide it was appropriate to address these concerns, the options available would mirror those available for revenue transactions:
 - (a) Require enhanced display/disclosure;
 - (b) Classify transfers with time requirements as "other resources"; and
 - (c) Recognize a transfer with time requirements in net assets/equity and recycle through the statement of financial performance.

28. The advantages and disadvantages of these approaches have been addressed in the discussion of revenue above. However, staff consider that it is possible that consideration of whether the public interest is best served by compliance with the element definitions or by departing from those definitions to better meet the objectives of financial reporting and the QCs may be different for expenses than revenue. For example, the fact that the grantor has lost control of cash may be seen by some as being more significant than the grantor's intentions. The CAG is asked for its advice on this issue.

Question for the CAG

Is the public interest issue the same as for revenue, or are the public interest issues different? Which of the above approaches does the CAG consider best meets the public interest for expense transactions with time requirements?

The following fact pattern has been used to illustrate how the financial statements and/or notes would be presented for each of the approaches proposed.

Example: Transfer of general operating grant with time requirements

A Central government provides a general operating grant to a local government entity to be consumed over three years.

Specifications The agreement does not include any return obligation, any performance obligation or stipulation over use.

The central government has no enforcement mechanisms available to require the local government entity to consume the funding on specific activities.

Cost CU 300,000

Timing of payments The full CU 300,000 is paid on 29 December 20X1. The local government's balance date is 31 December 20X1.

Timing of expenditure The local government expects to spend the funds as follows:
20X2 CU 100,000
20X3 CU 150,000
20X4 CU 50,000

For the purposes of these examples, other revenue and expenses are considered to balance to zero.

Option (a) – Enhanced Display and/or Disclosure

Statement of Financial Performance				
For the period ended 31 December 20X1-20X4	20X1	20X2	20X3	20X4
<u>Revenue</u>				
Revenue – restricted (for use in 20X1 – 20X4)	300,000	XX	XX	XX
Revenue – unrestricted	XX	XX	XX	XX
Total revenue	XX	XX	XX	XX
<u>Expenses</u>				
Operating expense - restricted	XX	100,000	150,000	50,000
Operating expense - unrestricted	XX	XX	XX	XX
<u>Net surplus/(deficit)</u>	300,000	(100,000)	(150,000)	(50,000)
Statement of Financial Position				
As at 31 December 20X1-20X4	20X1	20X2	20X3	20X4
<u>Current assets</u>				
Bank	300,000	XX	XX	XX
<u>Accumulated surplus/(deficit)</u>				
Restricted	300,000	200,000	50,000	-
Unrestricted	XX	XX	XX	XX

Note disclosure in the 20X1 financial statements

Total revenue of CU XX includes a general operating grant of CU 300,000, which is to be used over the period 20X1-20X4. As no related expenditure has been incurred in this year, the full amount is included in accumulated surplus/deficit. Accumulated surplus/deficit is CU XX, within this amount is CU 300,000 of revenue that has been recognized in the statement of financial performance. This resource is restricted for use to fund the general operations of the entity for the years 20X2 - 20X4. The reconciliation of this restricted fund is presented below.

Note disclosure in the 20X2-20X4 financial statements

Accumulated surplus/deficit is CUXX, within this amount is CU 100,000 (20X3: CU 150,000; 20X4: CU 50,000) of restricted operating expense that has been recognized in the statement of financial performance. This expense was funded by a restricted resource of CU 300,000 received in 20X1. This resource is to be used for the general operations of the entity for the years 20X2-20X4. The reconciliation of this restricted fund is presented below.

Restricted funds	20X1	20X2	20X3	20X4
Opening balance	0	300,000	200,000	50,000
Revenue during the period	300,000	0	0	0
Funds used during the period	0	100,000	150,000	50,000
Closing balance	300,000	200,000	50,000	0

Option (c) – Classify transfers with time requirements as ‘other obligations’

Statement of Financial Position

As at 31 December 20X1-20X4	20X1	20X2	20X3	20X4
<u>Current assets</u>				
Bank	300,000	XX	XX	XX
<u>Other obligations</u>				
Restricted revenue	300,000	200,000	50,000	

Statement of Financial Performance

For the period 31 December 20X1-20X4	20X1	20X2	20X3	20X4
<u>Revenue</u>				
Grant	XX	100,000	150,000	50,000
<u>Expenses</u>				
Operating expense	XX	100,000	150,000	50,000
Net surplus/(deficit)	0	0	0	0

Option (d) – Recognize a transfer with time requirements in net assets/equity and recycle through the statement of financial performance

Statement of Changes in Net Assets/Equity			
For the period ended 31 December 20X1-20X4			
	Other reserves	Accumulated surpluses/(deficits)	Total
Opening balance - 31 December 20X0	XX	XX	XX
Restricted reserve	300,000	XX	300,000
Net revenue recognized directly in net assets/equity	300,000	XX	300,000
Surplus/deficit for the period	0	0	0
Total recognized revenue and expense for the period	300,000	XX	XX
Closing balance - 31 December 20X1	300,000	XX	XX
Opening balance - 31 December 20X1	300,000	XX	XX
Transfer from restricted reserve	(100,000)	XX	(100,000)
Surplus/deficit for the period	0	0	0
Total recognized revenue and expense for the period	100,000	XX	XX
Closing balance - 31 December 20X2	200,000	XX	XX
Opening balance - 31 December 20X2	200,000	XX	XX
Transfer from restricted reserve	(150,000)	XX	(150,000)
Surplus/deficit for the period	0	0	0
Total recognized revenue and expense for the period	150,000	XX	XX
Closing balance - 31 December 20X3	50,000	XX	XX
Opening balance - 31 December 20X3	50,000	XX	XX
Transfer from restricted reserve	(50,000)	XX	(50,000)
Surplus/deficit for the period	0	0	0
Total recognized revenue and expense for the period	50,000	XX	XX
Closing balance - 31 December 20X4	0	XX	XX

Statement of Financial Position				
As at 31 December 20X1-20X4	20X1	20X2	20X3	20X4
<u>Current assets</u>				
Bank	300,000	XX	XX	XX
<u>Other reserves</u>				
Restricted	300,000	200,000	50,000	0
Unrestricted	XX	XX	XX	XX
Statement of Financial Performance				
For the period 31 December 20X1-20X4	20X1	20X2	20X3	20X4
<u>Revenue</u>				
Grant – reclassified from reserves	XX	100,000	150,000	50,000
<u>Expenses</u>				

Grants and Other Transfers (Revenue and Expenses)
IPSASB CAG Meeting (December 2018)

Operating expense	XX	100,000	150,000	50,000
<u>Net surplus/(deficit)</u>	0	0	0	0

Appendix A: IPSASB Due Process Checklist (condensed to included portions relevant to the CAG)

Project: Revenue and Non-exchange Expenses

#	Due Process Requirement	Yes/No	Comments
A. Project Brief			
A1.	A proposal for the project (project brief) has been prepared, that highlights key issues the project seeks to address.	Yes	The IPSASB considered the project brief at its March 2015 meeting (see Agenda Item 10).
A2.	The IPSASB has approved the project in a public meeting.	Yes	See the minutes of the March 2015 IPSASB meeting (section 10) .
A3.	The IPSASB CAG has been consulted on the project brief.	N/A	<ul style="list-style-type: none"> This step is not in effect for this project.
B. Development of Proposed International Standard			
B1.	The IPSASB has considered whether to issue a consultation paper, or undertake other outreach activities to solicit views on matters under consideration from constituents.	Yes	The IPSASB issued Consultation Paper, <i>Accounting for Revenue and Non-Exchange Expenses</i> in August 2017.
B2.	If comments have been received through a consultation paper or other public forum, they have been considered in the same manner as comments received on an exposure draft.	N/A	Yes, the IPSASB received feedback on responses to the consultation paper at the March 2018 meeting.
B3.	The IPSASB CAG has been consulted on significant issues during the development of the exposure draft.	Yes	Agenda Item 5.2 at the March 2018 meeting sought the CAG's views on the significant issues to be address in the development of the exposure draft.
			This Agenda Item further seeks CAG's views on significant issues to be addressed in the development of the exposure draft.

#	Due Process Requirement	Yes/No	Comments
<i>D. Consideration of Respondents' Comments on an Exposure Draft</i>			
D4.	The IPSASB CAG has been consulted on significant issues raised by respondents to the exposure draft and the IPSASB's related responses.	N/A	
D5.	Significant comments received through consultation with the IPSASB CAG are brought to the IPSASB's attention. Staff have reported back to the IPSASB CAG the results of the IPSASB's deliberations on those comments received from the CAG.	N/A	

Appendix B: Links to Other Documents

29. This appendix provides links to document which may be useful to CAG members in providing a background related to the project.
- (a) [Revenue project page](#)
 - (b) [Consultation Paper, Accounting for Revenue and Non-Exchange Expenses](#)
 - (c) [IPSASB Accounting for Revenue and Non-Exchange Expenses Webinar](#)